GROWTH AND PROFITABILITY OF SELECTED PUBLIC SECTOR COMMERCIAL BANKS IN INDIA SINCE 1991

by

Rajesh Kumar Mehrotra

Guide: Prof. Dr. P. N. Mehrotra

A thesis submitted to the University Of Allahabad, Allahabad

For the Degree of Doctor of philosophy

In Economics

Department Of Economics

Univesity Of Allahabad

J anuary 99

Dated : 6th January 1999

Certified that the thesis entitled " Growth and Profitability of Selected Public Sector Commercial Banks in India Since 1991 " is the original work Sri Rajesh Kumar Mehrotra carried under my supervision.

I approve its submission for the award of D. Phil. Degree from the University Of Allahabad.

(P. N . MEHROTRA)

Professor and Head,

Economics Department,

University Of Allahabad.

HEAD
ECONOMICS DEPARTMENT
UNIVERSITY OF ALLAHABAD

Acknowledgements

I owe a debt of gratitude to Professor Dr. P.N.Mehrotra, my supervisor and guide, for providing me the valuable guidance, encouragement and help. He has been a source of inspiration for me at every stage of the progress of the reasearch work right from its inception and it is for this reason that it could be completed exactly in twenty months and it is indeed a satisfying experience.

I had the benefit of discussing the matter with several Professors at Allhabad Univeristy; Faculty Members at National Institute of Bank Management, Pune; Indian Institute Of Management, Lucknow; Institute of Economic Growth, Delhi; Indian Banks' Association, Bombay and Indian Institute Of Bankers, Bombay. The most oustanding have been the discussions with Dr. K. Satyanarayana and Sri V.S. Kaveri , faculty members at NIBM, Pune and Dr. P.C. Purwar of IIM, Lucknow; experts on the subject.

Several bankers at Reserve Bank Of India, Bombay and Delhi, State Bank Of India, Cental Office, Bombay and Lucknow L.H.O.; Bank Of India, Central Office, Bombay; Oriental Bank Of Commerce at Delhi; SBI Staff College at Hyderabad; Staff Training Centres of SBI at Allahabd, Lucknow and Kanpur have been a great resource. Sri J.K.Mathur, Circle Development Officer, State Bank Of India, Local Head Office at Lucknow has helped me in sanction of my study leave for undertaking the research project and rendering valuable guidance to me.

My son, Abhishek Mehrotra, a mathmatics scholar in his own right, has been instrumental in

assisting me in building the equation of the Bank Efficiency Model. My wife, Pramila has made silent sacrifices when my companions were books only.

A word about collection of data where I was at my wits end as data in different sources sometimes did not match. Under such circumstances, the data published by the RBI has been taken as final. However, errors and omissions are accepted.

Finally, I bow my head with repsect before my parents and the ALMIGHTY GOD.

(Rajesh Kumar Mehrotra)

6th January 1999

Research Scholar,

Economics Department,

University Of Allahabad.

CONTENTS

CHAPTER 1

ROLE OF FINANCIAL SECTOR IN ECONOMIC DEVELOPMENT

CHAPTER II

GROWTH OF COMMERCIAL BANKS IN INDIA

CHAPTER III

BANKING SECTOR REFORMS IN INDIA

CHAPTER IV

PROFITABILITY AND EFFICIENCY OF COMMERCIAL BANKS IN INDIA

CHAPTER V

STATE BANK OF INDIA : A PROFILE

CHAPTER VI

BANK OF INDIA : A PROFILE

CHAPTER VII

ORIENTAL BANK OF COMMERCE : A PROFILE

CHAPTER VIII

COMPARATIVE POSITION OF SELECTED BANKS AND DEVELOPMENT OF A MODEL " BANKEM "

CHAPTER IX

BANKING IN THE NEXT MILLENNIUM

CHAPTER X

GROWTH AND PROFITABILITY OF SELECTED PUBLIC SECTOR COMMERCIAL BANKS IN INDIA SINCE 1991

CHAPTER 1

ROLE OF FINANCIAL SECTOR IN ECONOMIC DEVELOPMENT

OUTLINE

PART I

1.1 THEORETICAL BACKGROUND

1.1.1 Need and growth of financial sector

1.1.2 Theoretical Contribution

1.1.3 Real Sector and Financial Sector : Action and Interaction

(a) Supply Leading Phenomenon

(b) Demand Following Phenomenon

(c) Interaction of Supply Leading and Demand Following Phenomena

1.1.4 Components of Financial Sector:

(a) Financial Institutions

(b) Financial Instruments

(c) Financial Markets

(i) Money Market

(ii) Capital Market

(a) Corporate Securities Market

(b) Government Securities Market

(iii) Credit Market

1.1.5 Role of central bank in economic development :

Promotional and regulatory

1.1.5.1 Financial Repression and Financial Reforms in developing economies

1.1.6 Empirical Studies

1.1.7 Studies based on Causality Analysis

1.1.8 Conclusion

PART II

1.2 ROLE OF FINANCIAL SECTOR IN ECONOMIC DEVELOPMENT OF INDIA

CHAPTER I

ROLE OF FINANCIAL SECTOR IN ECONOMIC DEVELOPMENT

1.1 THEORETICAL BACKGROUND

1.1.1 NEED AND GROWTH OF FINANCIAL SECTOR

Role of banks has to be examined in the larger context of financial sector and its contribution to economic development. Introduction of money and subsequent developments led to the genesis of financial intermediation. Money broadly serves as a medium of exchange, unit of account, standard of value and store of value and proved to be a great facilitator for all economic activities. Despite these functions of money, a pure money economy faced several constraints . In order to explain things better, let us assume existence of a 'pure money economy' or a 'rudimentary economy', 1 where money is the only asset. The choice of savers is limited. They can store the legal tender, which is an unproductive activity and its value may even register a decline on account of inflation. The other options with them are to utilise their savings for purchase of gold, real estate or physical assets , which may be difficult to handle, illiquid , risky and may attract lower rate of return. Self-financed investment may be another option but quantum of profitable investment may exceed the savings of surplus units and they may also not be ready to undertake risk. These factors acted as a disincentive to save, on one hand and on the other hand, resources were not available to the entrepreneurs. The result was hindrance and bottlenecks in economic development . Gurley and Shaw observed in their analysis that the 'rudimentary economy's' capacity for growth is limited by its financial system . With no financial assets other than money, there are restraints on savings , on capital accumulation and on efficient allocation of saving to investment , that depresses the rate of growth in output and income ." 2

The above constraints and limitations led to the genesis of financial intermediation. The act of saving was performed by the surplus units as hithertofore but in between the surplus units and deficit units , financial intermediaries started acting as a conduit. As a medium of exchange and store of

SOURCES:

1& 2 "MONEY IN A THEORY OF FINANCE " , John F. Gurley and Edward S. Shaw 1960 Edition, Page 13

value, money provided foundation for financial system through surplus units and deficit units in the economy. This role of financial sector, over a period of time, became vast and varied and its role has become very crucial for economic development.

1.1.2 THEORETICAL CONTRIBUTION:

If we trace the history of economic thought, we observe that the classical economists consisting of Adam Smith 3 and the neo-classical economists consisting of Alfred Marshall and others found that a close correlation exists between capital accumulation and economic development. Growth was thus seen to be predominantly influenced by real factors. But they paid little attention to the transfer mechanism of savings into investment process. It has to involve a financial route. It was left to Keynes to emphasise the discontinuity and deny the automaticity of conversion of savings into investment. The "money illusion" hypothesis led to the concept of forced saving and the mechanism of lower rate of interest was suggested as a remedy. Thereafter, the role of financial sector got a proper perspective after the publication of works of Gurley and Shaw in 1950s. They successfully elucidated the need of institutionalisation of saving and investment activities. 4

Goldsmith coined the term " financial super structure" comprising of the entire gamut of financial institutions, financial instruments and financial markets essential for economic growth. 5 The financial structure in the form of both primary and secondary securities accelerates economic growth and improves economic performance and it facilitates the migration of funds to the best use.

About the cause and effect relationship between financial and real sectors taking supportive or lead role, the following theories emerged:

1.1.3 REAL SECTOR AND FINANCIAL SECTOR : ACTION AND INTERACTION

Financial sector brings about economic development through interaction with real sector. Two schools of thought have emerged in this context : one assigns a lead role to the financial sector known as

SOURCES:

3 .Adam Smith observed in his book "WEALTH OF NATIONS" that "capital is the main determinant of the number of useful productive labourers, who can be set to work....Labour is put into motion by capital."

4. Ibid.

5. "FINANCIAL STRUCTURE AND DEVELOPMENT ", Goldsmith Raymond ,Yale University Press , New Haven 1969.

" Supply Leading Phenomenon", while the other assigns lead role to the real sector and is termed as "Demand Following Phenomenon ."

(A) SUPPLY LEADING PHENOMENON :

The supply leading phenomenon lays emphasis on the situation in which financial services take a lead role in economic development of a country and financial development occurs first. Financial resources represent supply side. They hold not only the supply line but also the sectoral allocation. "Supply leading" says Patrick," has two functions to transfer resources from traditional sector (non-growth sectors) to modern sectors and to promote and stimulate entrepreneurial response in these modern sectors....... New access to such supply leading funds in itself have substantial favourable expectational and psychological effects on entrepreneurs. It opens new horizons as to possible alternatives , enabling the entrepreneurs as " think big". This may be the most significant of all, particularly the countries where entrepreneurship is a major constraint on economic development." 6 Thus financial resources play a leading role in economic development and the real sector follows the above initiative and the *process of economic development gathers momentum.*

(B) DEMAND FOLLOWING PHENOMENON ;

This hypothesis assigns lead role to the real sector. As trade and industry progress, financial services required by them are provided by the financial system. The process of economic development in real sector emerges first. It becomes so pervasive and sweeping that the financial sector has to follow it . Thus financial sector is evolutionary in character and follows the growth of real sector. This school of thought states that modern financial institutions are, in fact, shaped by the growth of real sector. " As a consequence of real economic growth , says Lewis , " financial markets develop , widen and become more perfect , thus increasing the opportunities for acquiring liquidity and for reducing risk; which , in turn, feeds back as a stimulant for real growth ." 7

(C) INTERACTION OF SUPPLY LEADING AND DEMAND FOLLOWING PHENOMENA

Thus some economists lay emphasis on the role of financial sector while others stress the role of real sector. But the reality is that both the sectors are inter-related and inter-twined and this process leads to economic development . They can not be disentangled from each other. In fact a cause

SOURCES:

6. "FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH IN UNDER DEVELOPED COUNTRIES : ECONOMIC DEVELOPMENT AND CULTURAL CHANGE " **Hugh T. Patrick, EDCC 1966 Edition, Page 175**

7. " THE THEORY OF ECONOMIC GROWTH " **Arthur Lewis, New York 1970 Edition**

and effect relationship exists between these two sectors and this process leads to economic development. Irrespective of the fact whether it is a developing economy or a developed economy, there is always an interaction of supply and demand phenomena. These two sectors are symbiotic too because development of one leads to development of the other.

Other economists too have examined the role of financial institutions in economic development. Adelman and Morris are of the view that the development of financial institutions is the best indicator of the country's development potential . 8 In view of the aforesaid transformation mechanism provided by the financial institutions, there is a positive impact on production and income resulting in increased capacity to save and invest and a positive chain of economic development sets in. Porter holds similar views when he states, "The visible correlations in the world of financial and real development are indeed commanding . Whether one relates the development of the national financial system (howsoever measured) to its per capita income across the countries at the moment of time or across time for a particular country , the relationship between real and monetary variables is undeniable ." 9

Accepting the role of financial sector in promoting savings, Lewis states " There is a whole range of saving institutions that can be developed .... Experience shows that the amount of savings depends partly on how widespread these facilities are ." 10 The analysis of Lewis finds support from Wai, who observes that "statistical evidence seems to support the hypothesis that the greater the financial intermediaries, the larger will be the amount of national savings ." 11

In order to better explain the financial structure, we shall examine all the three components of financial sector viz. financial institutions, financial instruments and financial markets, in detail.

1.1.4 COMPONENTS OF FINANCIAL SECTOR

The financial sector has three components :

(a) Financial Institutions
(b) Financial Instruments
(c) Financial Markets

SOURCES:

8. "SOCIETY, POLITICS AND ECONOMIC DEVELOPMENT: A QUANTITATIVE APPROACH" Irma Adelman and Cynthia Morris , Baltimore, 1967 Edition

9. "A MODEL OF BANK PORTFOLIO SELECTION", R.C.Porter 1967 Edition

10. " THE THEORY OF ECONOMIC GROWTH " Lewis W. Arthur , New York 1970, Page 229

11. " FINANCIAL INTERMEDIARIES AND NATIONAL SAVINGS IN DEVELOPING COUNTRIES " Wai U Tun , New York 1972, Page 111

(A) FINANCIAL INSTITUTIONS

The financial institutions perform the basic function of financial intermediation and they act as conduit for transfer of financial resources from net savers to investors . In the process they perform the task of assets transformation by accepting primary securities and delivering secondary securities. Primary securities are issued by ultimate borrowers and secondary securities are claims or assets issued by financial institutions . "Financial intermediaries ", say Gurley and Shaw, " are interposed between ultimate borrowers and lenders to acquire the primary securities of the borrowers and provide other securities for the portfolios of the lenders ." 12 Thus the financial institutions , by creation of secondary securities , are in a commanding position to meet the diverse preferences of the savers in terms of yield , liquidity , risk and maturity. The services offered by the financial institutions help in alround development of the economy. They strengthen savings-investment function and give strong positive signals to the surplus and also to the deficit sectors of the economy. The payment mechanism is facilitated by banks. These factors promote development of the economy in all the sectors viz. industry , trade, agriculture and household sector .

(i) TYPES OF FINANCIAL INSTITUTIONS

In order to facilitate 'financialisation', a wide range of financial institutions intermediate through customer-friendly products . They can be classified in several ways based on the criteria adopted for classification viz. ownership , type of services rendered , statutory classification and area of operation. The financial institutions may be basically classified into Banking Institutions and Non-Banking Financial Institutions. Then there are Special Development Institutions , Regulatory Institutions, Credit Rating Institutions , Merchant Bankers , Factoring Companies and several other statutory and other institutions. Among the banking institutions , there is apex banking institution also known as Central Bank of that country, commercial banks, cooperative banks and in India, there are Post Office banking counters as well. Based on ownership, the financial institutions may be classified as private sector or public sector . Then, there are banks of the country or foreign banks. There may be regional banks as Regional Rural Banks in India . In addition to banks, there is non-banking financial sector. The non-banking companies , which are engaged in accepting deposits can be broadly grouped into non-banking non-financial companies (mostly manufacturing and trading companies), which mobilise deposits for the purpose of financing their own business activities , and the non-banking financial companies, which accept deposits for the purpose of lending and investment. Chit funds, equipment leasing , hire purchase companies are also non-banking financial companies. There are Provident and Pension Funds , Life Insurance Corporation , General Insurance Corporation , Mutual Funds and Housing Corporations etc.

SOURCES :

12. Ibid. page 94

(ii) ***PLACE OF COMMERCIAL BANKS AMONG FINANCIAL INTERMEDIARIES***

The classification of financial institutions as banking and non-banking financial institutions segregates commercial banks from other financial intermediaries. This segregation is based on the contention that the different categories of financial intermediaries provide differentiated products both to the lenders and borrowers. The Conventional monetary theory places commercial banks in a separate category among the financial intermediaries because (a) banks create money, (b) bank's demand deposits are accepted as medium of exchange and included in the definition of money and (c) they are subjected to central bank's controls in a manner in which other intermediaries are not controlled.

Gurley and Shaw did not agree to the above line of thinking and pointed out that banks are among the many of their kind and not a class among themselves. 13 They alongwith other economists like Don Patinkin treated the theory of banking system as a part of overall optimum portfolios of assets and debts by financial institutions of various kinds . 14 Their analysis is broader and includes non-banking financial intermediaries also. The above economists observed that "Both types of financial institutions create financial claims; and both may engage in multiple creation of their liabilities in relation to any one class of assets they hold. Both act as intermediaries in the transfer of unspent incomes from surplus to deficit units" 15 As such financial system should be taken as a unified structure with banks being one of the members of this family.

(B) ***FINANCIAL INSTRUMENTS***

The financial system deals with financial instruments , which are also known as financial assets , financial claims or securities . Financial securities are classified as primary and secondary securities. The primary securities , also known as direct securities are issued by ultimate investors directly to the ultimate savers such as equity (ordinary) shares , preference shares , industrial debentures or bonds. The secondary securities are issued by financial intermediaries such as deposits made with the banking institutions , insurance plans , units and certificate of deposits.

Primary Securities

Ultimate investors <—> Direct Savers
<— Directly—>

Secondary Securities

Ultimate Investors\ / Savers
| Through Financial Intermediaries |

SOURCES:

13. " FINANCIAL ASPECTS OF ECONOMIC DEVELOPMENT" Gurley John G. Shaw E.S , AER 1955 Edition , Page 515-538 and also in their later work "FINANCIAL INTERMEDIARIES AND THE SAVING-INVESTMENT PROCESS", Journal Of Finance May 1956 & " MONEY IN A THEORY OF FINANCE " 1960

14. "FINANCIAL INTERMEDIARIES AND THE LOGICAL STRUCTURE OF MONETARY POLICY " Don Patinkin AER March 1961 Page 202.

15. " MONEY IN A THEORY OF FINANCE ", John G. Gurley and E.S.Shaw 1961 Edition Page 202

The thrust is on increasing the array of assets so that the savers are in a position to exercise their preferences in regard to liquidity, rate of return, diversification of risk and convenience in investment etc. Wide ranging and diversified assets, on one hand, open more avenues to invest and, on the other hand, lead to deepening and widening of financial markets The investment characteristics of financial assets are liquidity, marketability, transferability, transaction costs, risk of default, maturity period, options and tax status etc. These features influence preference of depositors.

The number and variety of financial instruments increase due to innovations and technological advancement. The urge of the financial institutions, for better customer service, also leads to innovation of new customer friendly financial instruments. The Certificate of Deposits, Commercial Paper , Securitised debts and Financial Futures are new variety of financial instruments. In addition to fund-based instruments, there are non-fund based instruments as well e.g. letters of credit and bank guarantees issued by the banks. Larger the choice of financial instruments to meet the requirements of surplus units, larger is the flow of savings. It increases income and makes possible to enlarge the number of surplus units. On the other hand, "the need to accumulate capital and sustain economic growth increases the number of deficit units." 16 It leads to enlargement of financial sector to meet their requirements and promotes economic development.

"The nature, composition and growth of financial assets or claims" observed Chakravarty Committee, in its Report dated the 10th April 1985, " indicate the sophistication , development and growth of the financial system and hence the overall financial development of the economy." 17 " The introduction of financial instruments ," rightly observed Drake, " provide a bridge between ultimate savers and investors and creates an opportunity for putting saving of the nation at the disposal of the enterprising ; thus promising to raise the total level of investment and hence of income." 18 Larger the choice of financial instruments to meet the requirements of surplus units , larger is the flow of savings.

(C) FINANCIAL MARKETS

Development of financial markets is another facilitating factor both to the deficit and surplus units. It imparts liquidity and increases flow of funds by faster settlement and payment mechanism. There is also incentive to carry idle cash balances to the market and economy is affected in holding of transactional balances. 19

SOURCES:

16. " Money, the Financial System and Monetary Policy, Hall Prentice. N.J. 1986 Page 76

17. Ibid., Page 49

18. " Money , Finance and Development " P. J. Drake 1980 Edition Page 12.

19. " Securities Markets in Less Developed Countries", P.J. Drake, JDS 1977 Pages 73-80.

Financial markets are of three types (i) Money Market (ii) Credit Market (iii) Capital Market . The essential purpose of these markets is projected below:

Money Market	Capital Market	Credit Market
Short term financial assets	Long term financial assets	Short term Medium Term Long Term Credit requirements

(i) *MONEY MARKET :*

Money market is a market for short term financial assets . The lending and borrowing of short term funds takes place here. Short term generally refers upto a period of one year. It comprises of many sub-markets viz. Inter- Bank Call Money Market , Bills Discounting Market and Treasury Bills Market etc. The treasury bills bring flexibility into funds management as they have a ready market both for sale and purchase .When tight money market conditions prevail, the money markets rates rise and when easy conditions prevail, the money market rates fall. The central bank, commercial banks, cooperative banks , insurance companies and Unit Trust Of India are main participants . The central bank is an important constituent in the money market as it can influence the cost and availability of funds in the market through monetary regulations. A strong central bank is a essential for a well organised and developed money market. The high volatility of interest rates in these markets is an unsatisfactory feature and can be contained to a great extent by a better asset-liability management by banks and also by suitable action by the central bank.

(ii) *CAPITAL MARKET :*

The capital market or stock market plays a critical role in the growth process. It helps to augment capital formation. According to Professor Hicks, the industrial revolution of England was ignited more by the presence of a liquid financial market rather than the technological innovations. 20 The capital market deals with long term securities and is classified into two categories :

Capital Market

Corporate Securities Market — *Government Securities Market*

(a) *CORPORATE SECURITIES MARKET :*

Until recently the Governments and central banks in several developing countries paid very little

SOURCES:

20. Professor Hicks writes interestingly " What happened in the Industrial Revolution ..... is that the range of fixed capital goods that were used in production .... began noticeably to increase ...... But fixed capital is sunk; it is embodied in a particular form, from which it can only gradually...... be released. In order that people should be willing ..... to sink large amounts of capital..... it is the availability of liquid funds which is crucial. This condition was satisfied in England .... by the first half of the eighteen century ."

attention to the potential economic benefits of equities as a source of finance. The relative lack of development of equity market can be explained by the Government policies favouring the use of short term financial facilities instead of equities and long term securities. Central banks in many developing countries have yet to make required orientation towards development objectives, in general or evolving a sound financial structure including capital market institutions and instruments, in particular. 21 Moreover, it suited the corporates to avail loans from financial institutions at low rates because of administered interest rates.

But equity market has advantages of its own. It helps both the investors and the corporates and it should be seen as a means of expanding options for both the above units. Savers can increase their choices in terms of risk, return, security, liquidity and maturity of their financial assets. Companies can have recourse to long term funds and can also improve their net worth and debt-equity ratio. It also contributes to the stability of the country's financial system by reducing the vulnerability of companies to floating and high real interest rates. The equity market promotes growth and employment by establishment of new companies and/or growth of the existing companies.

There is an element of competition between equity market and credit market as regards the financial requirements of large corporates who can access the capital market. But in the long run, growth of equity market helps in growth of credit market for two reasons : all the requirements of funds of even the corporates can not be fulfilled by capital market and secondly, while approaching the credit market they require equity from the capital market. So both the markets may be looked as complementary. Moreover, banks may also handle new capital issues in their capacity as merchant bankers.

(b) GOVERNMENT SECURITIES MARKET :

Government securities are important financial instruments in the financial markets of the country. The issue of Government securities is linked with the Government's internal debt management policy. Debt management tries to optimise maturity and cost. Government securities are highly liquid and safe. The major investors in the gilt-edged market are commercial banks, insurance companies, provident and other trust funds. The gilt-edged securities are an important tool of the monetary credit control technique i.e. open market operations undertaken by the central bank of the country. But interest on Government securities must be market-based as it facilitates the widening and deepening of financial markets.

(iii) CREDIT MARKET

The institutional sources of credit can be classified into three groups : banks, non-banking financial

SOURCES:

21. "THE ECONOMICS OF FINANCIAL REFORM IN DEVELOPING COUNTRIES ", Wilbert O. Bascom , Chief Bureau of International Banking, State of Florida.

companies and developmental financial institutions. Banks can be further classified into commercial and cooperative banks. The functions of commercial banks have enlarged with the passage of time. Initially they were concentrating on working capital advances and thereafter they also started providing medium term loans and also long term loans on selective basis. Next chapter has been devoted to commercial banks and their lendings in India have been discussed in detail. There are State Co-operative Banks, Central Co-operative Banks, State / Land Development Banks, Primary Agricultural Credit Societies and Primary Land Development Banks. These banks are based on the concept of local feel for providing coverage. The credit portfolio of Developmental Financing Institutions and Non-Banking Finance Companies in India have been analysed in second part of this Chapter.

1.1.5 ROLE OF CENTRAL BANK IN ECONOMIC DEVELOPMENT: PROMOTIONAL AND REGULATORY

The role of central bank in economic development of a country can be grouped under two heads : regulatory and promotional. Some bankers are of the view that in developed countries, it is the regulatory role of the central banks that is emphasised but in case of a developing country, the promotional role assumes significance. 22 There is an element of truth in it when viewed from historical perspective of development. But in the long run, both the roles are complementary in both types of economies and are exercised depending upon the need of the situation.

Autonomy of the central bank has also been an important issue. The argument in favour of independent central banks is based on the argument that monetary stability, which is essential for the efficient functioning of the modern economic system, can be achieved if the task is entrusted to professional central bankers, who can take a long term view of the monetary policy. Too much concern for the short term can result in 'stop-go' policies. 23

SOURCES:

22. " It is not surprising since at the time of establishment of central banks in these (developed) countries financial systems were already fairly well developed. By contrast, central banks in developing countries could not confine simply to the role of regulators" says R.N.Malhotra, ex-Governor, Reserve Bank Of India . Excerpts from the nineteenth Frank Mores Lecture delivered at Chennai on September 3, 1990.

23. Excerpt form " Tenth M.G.Kutty Lecture" delivered by Sri C. Rangarajan, ex-Governor, Reserve Bank Of India at Calcutta on September 17, 1993. He further states, " at one end of the spectrum , there are central banks which are almost viewed as being subordinate to the Government, in the sense, that stance of monetary policy is primarily determined by the Government even though the central banks may play an important role in advising the respective Governments. Example of central banks which fall in this category are Bank Of England, Bank Of Japan and Bank Of France. In relation to Bank Of France, legislative changes have been introduced very recently to give the bank greater autonomy. At the other end of the spectrum are countries where central banks remain independent of the Government and take monetary decisions of their own. In this category fall the Federal Reserve System in the United States and the Bundesbank in Germany..... Vesting a central bank the sole authority to determine monetary policy has, however, not found universal acceptance."

The instruments of monetary regulation exercised by the central banks are the following:

Bank Rate	Open Market Operations	Cash Reserve Ratio	Statutory Liquidity Ratio	Selective Credi Control	Moral Suation

1.1.5.1 Financial Repression and financial Reforms in developing economies and the role of central bank

In their anxiety for promotional role, central banks and Governments in some of the developing countries adopted control measures like artificial lower rate of interest, directed credit to certain sectors even at the cost of cross subsidisation and higher reserve requirements.

A developing economy is characterised by low levels of saving and investment, labour is abundant, capital is scarce, there is widespread unemployment and underemployment. So the Government and central bank of the country intervene. They prescribe administered interest rates which are kept low through ceilings. The argument is that due to interest sensitivity of demand for credit, cheaper finance is the remedy. It does not reflect the correct position because capital being scarce, the rates of interest should not be low. This situation creates distortions both in savings and investment. Low rates of interest act as disincentive to save. Inflation makes nominal rates of return on savings still lower in real terms acting as further disincentive to save. Interest on Government securities is also low. The absence of an organised securities market and a financial sector repressed by Government policies, the portfolio choice of some wealth holders would be restricted to the acquisition of physical assets and real estate. Wealth owners also attempt to maximise their return and minimise the risk by acquiring assets in the financial sector of the developed countries where Government intervention is less pervasive. Such developing economies are known as *financially repressed economies.*

Ronald Mckinnon and Edward Shaw made financial sector analysis of developing countries, which are financially repressed. Their central argument is that indiscriminate distortion of financial prices including interest rates and foreign exchange rates reduce the real rate of growth and the real size of financial system relative to non-financial magnitudes. In all cases this strategy has stopped or gravely retarded the development process. 24 Their prescription is removal of distortions imposed by the Governments and central banks in these countries.

In a study on central banking in developing countries conducted at the instance of Bank Of England in 1995 observed in the developing countries for whom study was undertaken (44 developing countries 16 from Africa, 11 from Asia, 7 From Middle East and Europe and 10 from Western Hemisphere referred to as Bank Of England Group) instruments of financial repression include liquid asset requirements, priority sector credit allocation, preferential rediscount facilities and credit guarantee schemes. Loan rate ceilings have also

SOURCES

24. " FINANCIAL DEEPENING IN ECONOMIC DEVELOPMENT ", OUP, 1973, E.S.Shaw & " Money and Capital in Economic Development , OUP 1973 , R.W.Mckinnon.

been imposed in some of the BOE Group countries; Chile, Cyprus, *India*, Kuwait, Malta, Nigeria, Soloman Islands and South Africa. In majority of BOE group, Government bill or bond rates are administratively determined.........Changes over the past 2 decades in the BOE Group suggest that financial repression is on the wane as a source of Government revenue, perhaps in part as a result of the accumulated evidence of the deleterious effect on economic growth (destabilising portfolio shifts from financial to tangible assets when inflation accelerates." 25

Thus the remedy of the problems lies in financial reforms. By restoration of demand supply market mechanism, realistic prices of financial assets are obtained i.e. the true situation arising out of capital scarcity is reflected . It reverses the maladies arising out of distortions created by financial repression . The rate of domestic saving to income is substantially increased. Not only nominal rates of interest take care of present inflation but they are forward looking too and take care of expected rate of inflation. Thus there are incentives to save. The flight of savings to foreign countries is not only stopped but may even be reversed in the course of time and funds inflow may take place. With generation of financial resources in the form of saving, the inflationary methods of financing come to an end and economic stability is ensured.

Alignment of interest on loans and advances to market rate ensures allocative efficiency of resources. Financial deepening of the system takes place, which is reflected in opportunities for substitution of investment over current consumption. The menu of financial assets is enlarged and gives wider range of choice for investment.

Correct price mechanism of resources in the form of appropriate interest rate helps in adoption of correct techniques for production. The distortions in favour of capital intensive techniques are corrected; otherwise it entails a higher cost and becomes non-viable. The correct mix of capital-labour techniques is ensured by decision making based on operation of market forces.

With greater avenues for investment and production, the monopolistic and oligopolistic trends are also corrected. Competition takes control of the situation and economic development generates a positive trend generating higher production and income with further inducement to save and so on.

1.1.5.2 Reactions to Financial Reform

Since the mid 1970s several Latin American and Asian countries have implemented financial reform policies aimed at reducing or eliminating Government control of domestic interest rates and credit allocation. The reforms did not succeed at Chile, Argentina and Uruguay but that was not the fault of the financial system. The main reasons were high and volatile interest rates, overvalued exchange rate, unstable macro-

SOURCES

25. " CENTRAL BANKING IN DEVELOPING COUNTRIES : OBJECTIVES , ACTIVITIES AND INDEPENDENCE ", Maxwell J. Fry , Charles A.E. Goodheart and Alvaro Almedia , Routledge , London

economic environment and absence of reforms in other sectors like industry, trade and labour markets. The adverse impact of overvalued assets was inadequately evaluated by banks, which continued to finance the purchase of overpriced assets. Price stability is also important for a successful reform programme. Effective inflation control depends on the willingness and ability of the Government to control monetary expansion, which depends, among other things, on financing of budget deficit.

In the latest development, the recent Asian currency crisis, which started with Thailand in July 1997 and gripped other South East Asian countries like Philippines, south Korea, Malaysia and Indonesia show that financial sector reforms were not accompanied by proper macro economic setting and prudential norms. The results of financial sector reforms in India, which are part of economic reforms have been encouraging and have been insulated against the above shocks, have been examined in detail in Part II of this Chapter.

Vincent Galbis,26 a follower of Mckinnon and Shaw School of thought, stated that a developing economy has fragmented markets and dualistic pattern of production. A backward inefficient sector (Sector I) exists with modern efficient sector (Sector 2) using modern technology. Sector I is deprived of bank credit and is self-financed. Sector 2 gets bank finance and in large sum due to indivisibilities requiring large sums of capital and is facilitated by administered low rate of interest. In order to correct dualism and distortions, this model stresses the need for market driven rate of interest for ensuring investment efficiency with higher economic growth.

The above viewpoint was critised by an intrusive 'interventionist ' school of thought led by Stiglitz and Weiss. They have argued that competitive market equilibrium in a free economy is not an optimal situation due to asymmetric information problems. The deregulated interest structure makes market rate to shoot creating adverse selection problems. Banks tend to finance riskier projects affecting the quality of their portfolio. Therefore, 'credit rationing' through a ceiling on interest rate to restore desired level of allocation of credit has been proposed to reduce the chances of credit market failure.

Kalecki 27 and Taylor 28 observed structural problems as the real cause of retardation of growth in developing countries. These economists were known as Neo-Structuralists. They pointed out the existence of the market inefficiencies in developing countries which hamper the development process.

SOURCES:

26. " FINANCIAL INTERMEDIATION AND ECONOMIC GROWTH IN LESS DEVELOPED COUNTRIES , A THEORETICAL APPROACH " Galbis V. Journal Of Development Studies 13, pp. 58-71

27. " ESSAYS ON DEVELOPING ECONOMICS ", M. Kalecki , Harvester Press , Brighton 1976

28. " STRUCTURALIST MACRO-ECONOMICS : APPLICABLE MODELS FOR THE THIRD WORLD ", Taylor L., Basic Books, New York , 1983

1.1.6 EMPIRICAL STUDIES

The empirical studies by Gurley 29 in mid 1960s worked out the ratio of total financial assets to Gross National Product (GNP). It showed correlation between growth and financial assets. For the poorest countries, it was not more than 0.5, for middle group of countries it was between 1 and 1.5. More prosperous countries like France and Israel had highest ratio between 2 and 3 and in case of super economies, it was between 4 and 5. The positive relationship between the degree of intermediation and the rate of growth of GNP was confirmed by Wallich in his cross section study of a number of countries. 30 Goldsmith in his study pointed out "the evidence now available is more in favour of the hypothesis that there exists only one major path of financial development, a path marked by certain regularities in the course of the financial interrelations ratio, in the share of the financial institutions in the total financial assets , and the position of the banking system...... a path from which they (countries) have deviated only to a minor extent." 31 He used cross section time series data for the period 1880 to 1963 for 18 countries both developing and developed. Developed countries had higher FIR than the developing countries. Positive correlation between FIR and GNP was certainly present.

The overall view of what is called by Goldsmith as ' Financial Super Structure' has to be viewed in terms of three financial ratios: Financial Interrelations Ratio (FIR), Finance Ratio (FR), and Intermediation Ratio (IR). FIR is the ratio of the total volume of financial assets in the economy at any point of time to the stock of physical assets at that time. It reflects the basic aspects of the country's financial structure and development, namely, the relation between its financial structure and its real asset structure. It is an indicator of the rate of financial development in relation to the rate of economic growth. FR is measured as the ratio of total financial claims issued during a year in the economy (financial issues) to national income. It is an indicator of the rate of financial development in relation to the rate of economic growth. IR is measured as the ratio of the volume of financial instruments issued by the financial institutions, called secondary issues, to volume of primary issues by the non-financial units. The IR provides the most general indicator of the degree of institutionalisation of financing in the economy. There is one more ratio i.e. NIR, which is measured as the ratio of primary issues to net physical capital formation in the economy. Thus with the above ratios the sophistication, development and growth of the financial system can be measured. Goldsmith has also pointed out a positive association between the development of financial structure and the stages of economic development. 32

SOURCES:

29. Ibid. , Gurley John G.

30 . " MONEY AND GROWTH, A CROSS SECTION ANALYSIS ", Henry C. Walich 1969 Edition Page 281-302

31 &32. " THE DETERMINANTS OF FINANCIAL STRUCTURE ", Raymond W. Goldsmith, Paris 1966 and FINANCIAL STRUCTURE AND ECONOMIC GROWTH", 1969 by the same author.

Fry 33 studied data for 7 Asian countries for the period 1962 -72 and found that the real rate of interest had a positive effect on saving and economic growth of those LDCs. King and Lavine 34 studied data of 80 countries for the period 1960-89 and by using simple correlation measures they concluded that each financial indicator was positively and significantly correlated with each of growth indicators. These financial indicators were (a) ratio of the size of the formal financial intermediary sector to GDP, (b) importance of banks relative to central bank, (c) the percentage of credit allocated to private firms and (d) the ratio of credit issued to private firms to GDP.

1.1.7 STUDIES BASED ON CAUSALITY ANALYSIS :

Jung 35 selected 56 countries (19 developed and 37 developing). He used 'Currency Ratio' (ratio of currency to M1) and monetisation variable (ratio of M2 to GDP) and found some evidence of supply leading causality pattern in LDCs more frequently than a demand following pattern thereby establishing the usefulness of financial development in these countries. When the currency ratio was related as a measure of financial development, a supply leading and then demand following causality pattern during the course of development was observed. Thus the LDCs were characterized by the causal direction running from financial sector development to economic development and developed countries by reverse causal direction. The monetisation variable did not show the aforesaid causality variation.

1.1.8 C ONCLUSION

Thus there is close link between growth of financial sector and economic development as is evidenced by the above theoretical, empirical and causality studies. The spread of financial institutions meets core needs of the economy like pooling of resources from the surplus units, to allocate credit to the deficit units, transfer of economic resources across distance, facilitating payments mechanism and clearing system of financial instruments, managing risk by diversifying and hedging and price information of the financial assets. Financial institutions, specially the banks also play a catalytic role by creating credit in anticipation of savings and it gives push to production. The financial institutions do useful transformation mechanism like liability-asset transformation (mobilisation of savings of surplus units and channelising them to the deficit units), size transformation (consortium advances are a unique example), maturity transformation (deposits and advances of different tenors), risk transformation (by diversification and their expertise) and meet the needs of the savers and investors. Thus savings-income ratio increase and it is known as direct institutional effect on savings. This is supported by economists like Lewis, Irma, Adelman, Cynthia Morris

SOURCES:

33. " MONEY , INTEREST AND BANKING IN ECONOMIC DEVELOPMENT " Fry M.J. (1988) , The John Hopkins University Press , Baltimore pp. 60-98.
34. " FINANCE , ENTREPRENEURSHIP AND GROWTH " King R., Levine R. 1993, Journal Of Monetary Economics Vol. 32 pp. 513-542
35. "FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH : INTERNATIONAL EVIDENCE ", Jung W.S., Economic Development and Cultural Change", Volume 34 No. 2 1986 pp. 333-346

and Maxwell J. Fry. Prof. P.N. Mehrotra 36 also pinpoints in his Research paper the significant role of financial sector in the savings-investment process in the economy.

Financial sector and real sector act and react on each other. While it is only a matter of academic interest whether real sector or financial sector takes a lead but the fact remains that their interaction leads to economic development. Both of them are thus symbiotic.

The distinction between banks and non-banking financial intermediaries is blurring now with the emergence of the concept of 'universal banking', a term coined in USA to denote that financial sector has to undertake a host of financial services. The banks, which were hithertofore, concentrating on working capital needs of the borrowers have to increase their horizon and extend term loans even for longer maturities and for larger amounts. These developments are good for the economy as they will increase availability of resources to entrepreneurs.

The array of financial assets has grown. Their classification lies in the basic characteristics like liquidity, marketability, transferability, maturity period, tax status, transaction cost and options. Several new instruments like CDs, CPs , securitised debts and financial futures have come to the financial market. The development of mutual funds and enactment of legislation to protect investor's interest are also facilitating factors for flow of funds to capital market. With the growth of information technology, the investor is much better informed and invests after making risk-return analysis. Banks are also assisting capital market as merchant bankers and managers to new issues

Central banks have their promotional and regulatory role for development of financial markets. Through various credit control measures, they send signals to the financial institutions. But these measures have been misused too as has been observed by Mckinnon and Shaw in their studies of the developing economies. The cases of financially repressed economies of the developing countries all over the world are the example. In a study of 44 developing economies of the world spread over Asia, Africa, Middle East , Europe and Western Hemisphere, it has been found by the economists like Maxwell J.Fry, Charles A.E.Goodheart and Alvaro Almedia that the measures like reserve requirements, administered interest rates and directed credits have been misused. The measures have caused distortions in developing economies. Despite paucity of capital, the administered rates of interest were lower and it discouraged savings and investment was also channelised to inefficient sectors and wrong techniques of production were chosen The remedy lies in financial sector reforms. But these reforms did not succeed in some countries as they were not accompanied by reforms in other sectors like industry and trade and measures were not taken to control

SOURCES:

36. ... " financial institutions strengthen significantly the saving-investment process in the economy, allocate available savings efficiently in socially desirable channels, augment the savings capacity by financial innovation and suitably alter the economic environment of the economy." ROLE OF FINANCIAL INSTITUTIONS IN ECONOMIC DEVELOPMENT : A CASE STUDY OF U.P. " Prof. Dr. P.N. Mehrotra , Research Paper, Dept. of Economics, University of Allahabad, 1979

inflation and as such correctives had to be applied.

Thus financial system requires proper-macro economic set up and right sequencing alongwith structural reforms. Moreover, liberal approach has to accompany proper regulatory mechanism and prudential norms. With the integration of economies on a global basis, the problems in a country or a group of countries spreads to other countries and if the impact is severe it may become contagion. It has been experienced by several countries like Thailand, Phillipines, Malaysia, South Korea and Indonesia in the recent Asian Currency Crisis, which has been further analysed in Chapter IX. But Indian economy, despite the problems in the neighbouring countries has performed fairly well and had comparatively milder effect and remained insulated to a great extent against the above shocks. What have been the safeguards and what are the weak areas to be guarded, these aspects have, inter alia, been examined in the Part II of this Chapter.

PART II

1.2 ROLE OF FINANCIAL SECTOR IN ECONOMIC DEVELOPMENT OF INDIA

1.2.1 INTRODUCTION

After independence, Indian financial system functioned under highly regulated environment till 1990. Indian financial system has undergone rapid transformation over the last four decades, be it under a regulated regime or thereafter in the post-reforms phase. The financial system in India now comprises of an impressive network of financial institutions (a) in the public sector due to takeover of the undertaking of Imperial Bank Of India by State Bank Of India and making it as a public sector bank alogwith its 7 subsidiaries and thereafter nationalisation of 20 banks in two phases,(b) in the cooperative sector due to easier access to rural population and (c) in the private sector so as to bring in element of competition. The financial assets have grown in the all the sectors and markets whether it is banking sector, money market, Government bills and gilt-securities market and share market. The institutional support, regulatory bodies and accounting system are developing.

Short term credits are primarily handled by commercial and cooperative banks. But in the recent policy announcements, commercial banks have been assigned a bigger role in extending term loans too. Commercial banks constitute the largest segment of the financial sector and among them PSBs have the lion's share. Cooperative sector functions through Central and State Cooperative Banks, Primary Agricultural Credit Societies and a network of Primary Land development Banks.

Specialised Development Financial Institutions (DFIs) provide medium and long term credit to the corporate sector. Non-Banking Financing Companies (NFBCs) also undertake wide spectrum of financial activities. Money Market, and Capital Market also play an important role in providing short term and long term funds to the different sectors.

1.2.2 PHASES OF DEVELOPMENT

As entire exercise covers more than four decades from 1951 i.e. when First Five Year Plan was launched till the post-reforms phase and encompasses a number of financial institutions, it has been been divided into the following four phases:

(a) *Foundation Phase* : *(from 1951 i.e. commencement of economic planning to June 1969 i.e. pre-nationalisation period of commercial banks)*

(b) *Expansion Phase* : *(from July 1969 to 1984 i.e. post nationalisation expansion phase)*

(c) *Consolidation and diversification phase* : *(from 1985 to 1990 i.e. pre-reforms phase)*

(d) *Liberalisation and Reforms Phase* : *(from 1991 and onwards i.e.reforms and post-reforms phase)*

(A) FOUNDATION PHASE (From 1951 to June 1969)

When economic planning was launched in India in 1951, savings and investment and the rate of their growth were low. It was observed in the First Five Plan document that in an undeveloped country like India with low levels of standard of living and rapidly increasing population, the desirable growth rate in output can be achieved only if the rate of capital formation could be stepped up over years substantially above the level of 10 percent of gross domestic product (GDP) observed in 1950-51. 37

During first two decades form 1951 to 1970, the foundation of future progress was laid by enacting banking regulations and law. Extensive powers were vested with Reserve Bank Of India for supervision over banks particularly under Banking Companies Act 1949 (later renamed as Banking Regulation Act 194). Reserve Bank Of India ensured that many non-scheduled banks, which could not come to prescribed standards regarding the minimum capital requirements or could not comply with the prohibition of combining of non-banking business with banking business were closed down or merged with others. As a result of this process of reorganisation and consolidation, the total number of banks came down from 640 in December 1947 to 387 in December 1957.

The other steps included take over of the undertaking of Imperial Bank Of India by State Bank Of India on July 1, 1955, on the recommendation of Rural Credit Survey Committee, which stressed the need for " one strong, integrated, state sponsored, state partnered commercial banking institution with an effective machinery of branches spread over the whole country." 38 The other segment of the banking system i.e. cooperative banking system was also streamlined . By amending Act 23 of 1965, called the Banking Laws (Application Of Cooperative Societies) Act 1965, the then Banking Companies Act with certain modifications was made applicable to cooperative societies carrying on the business of banks.

Another significant development was establishment of Unit Trust Of India by the Government in February

SOURCES:

37. THE FIRST FIVE YEAR PLAN , Planning Commission , Government Of India

38. ALL INDIA RURAL CREDIT SURVEY COMMITTEE REPORT , 1954 Reserve Bank Of India

1964 with the twin objectives of :

(a) stimulating and pooling of savings of middle and low income groups
(b) enabling them to share the benefits and prosperity of rapidly growing industrialisation in the country.

National Industrial Development Corporation (NIDC), Industrial Credit And Investment Corporation Of India (ICICI), Industrial Development Bank Of India (IDBI), State Financial Corporations (SFCs) and State Small Industrial Development Corporations (SSIDCs) were also established during 1951-1969.

By the early 1960s it was realised that credit flow from banks was highly skewed, catering mainly to the limited sections of the society. A need to give banks a new sense of direction was recognised and it was, therefore, decided in 1967 to introduce 'social control' over banks. The Government, at that time, considered that the banks may continue to function in the private sector but further controls may be imposed upon them as would determine priorities for lending and investment, evolve appropriate guidelines for management and promote a reorientation of the decisions taking machinery of banks.

The total assets acquired by the banking sector and other financial institutions in the course of their lending to the deficit sectors increased phenomenally in absolute terms from Rs. 3,481 crore in 1950-51 to Rs.8,517 crore in 1960-61 i.e. an average annual growth of 14.5% and further to Rs. 26,038 crore in 1970-71 i.e. an average annual growth of 20.6%. as is observed from the following data :

Total assets of financial institutions in India

Source : given on next page (in crore of rupees) 39

	1950-51	1960-61	1970-71
I. Banking sector	2853	5811	17194
	(82.0)	(68.2)	(66.0)
(i) Reserve Bank Of India	1601	2478	5463
	(46.1)	(29.1)	(21.0)
(ii) Commercial Banks	1080	2257	6862
	(31.0)	(26.5)	(26.3)
(iii) Cooperative Banks	172	1076	4869
	(4.9)	(12.6)	(18.7)
II. Other Financial Institutions	628	2706	8844
	(18.0)	(31.8)	(34.0)
III. Total Assets Of (I+II)	3481	8517	26038

(Figures in bracket are percentages to total assets of financial institutions.)
Other Financial Institutions include small savings, provident funds, insurance companies, Unit Trust Of India, financial companies, industrial development banks (viz. IDBI, IFCI, ICICI, IRBI, SFCs, SIDCs), ECGC, DICGC d NABARD.

In addition to the substantial increase in the total financial assets, the relative shares of the financial institutions underwent significant changes. Whereas cooperative banks gained, the share of Reserve Bank Of India and commercial banks registered a decline. The other financial institutions' share also rapidly increased. *Thus cooperative banks and other financial institutions recorded a higher growth rate.*

The share of bank deposits in gross savings of household sector in the form of financial assets increased from 14.7% (1951-52 to 1955-56) to 35.1% (1966-67 to (1968-69). Their holding of currency also increased from 14.9% to 15.6%. It shows that despite an increase in the share of banks deposits, there was still scope for tapping savings by the financial institutions, which were held in the form of currency. The investment of the household sector in shares and debentures sharply declined from 13.7% to 1.9% during the relevant period. It shows a high degree of risk-aversion among the household sector investors and also lack of development of equity market. Deposits of scheduled commercial banks as percentage of national income was only 15.2%. Out of 8262 total branches of scheduled commercial banks in June 1969, only 1833 were rural branches accounting for 22 % of total branches. Bank credit to priority sector was 14 % of total bank credit. In absolute terms, out of total Scheduled Commercial Banks credit of Rs.3599 crore in June 1969, only Rs.504 crore was given to priority sector. In fact foundation for further progress was to be laid.

(B) EXPANSION PHASE (July 1969 to 1984)

The neglect of priority sector, skewed nature of credit flow and slower expansion of branches led to nationalisation of leading 14 commercial banks on 19th July 1969. Subsequently, on 15th April 1980, six more commercial banks were nationalised. After merger of one nationalised bank, the total number of nationalised banks is 19 in addition to State Bank Of India and its 7 subsidiaries. Thus the total number of Public Sector Banks (PSBs) is 27.

The main objective of nationalisation of banks had been to serve better the needs of the economy in conformity with the national objectives. Since 1969, commercial banks and in particular the 28 Public Sectors Banks have made rapid progress in various spheres of banking operations e.g. network of branches, deposit mobilisation, deployment of credit and financing of priority sector. Deposits with the scheduled commercial banks as percentage of national income rose from 15% in 1969 to 38% in 1984. The share of priority sector advances in total gross bank credit moved from Rs. 504 crore in June 1969 to Rs. 14,834 crore in June 1984. The priority sector lendings as percentage to total bank credit increased from 14% to 36.7% during the corresponding period, with a concomitant fall in the relatively large proportion of credit earlier enjoyed by the medium and large industry and trade. Thus credit flows were directed towards prioritized sectors viz. agriculture, small scale industries and small business finance. During this phase

SOURCES :

39. REPORT ON CURRENCY AND FINANCE ON CURRENCY AND FINANCE , Reserve Bank of India SUPPLEMENT TO BANKING & MONETARY STATISTICS OF INDIA (R.B.I.) 1964 TRENDS & PROGRESS OF BANKING IN INDIA (R.B.I.) ANNUAL REPORTS OF VARIOUS FINANCIAL INSTITUTIONS

Regional Rural Banks (RRBs) and National Bank for Agriculture and Rural Development (NABARD) with focus on priority sector were set up in 1975 and 1982 respectively. The average size of population per bank branch improved from 65000 to 15000. Further, the number of rural branches in total number of bank branches stood higher at 56% as compared with 22% in 1969 as new rural branches accounted for as high as 63.5% in the total number of new offices opened since nationalisation. Credit-Deposit Ratio, however, declined from 77.5% in June 1969 to 67.4% in June 1984 40 due to faster expansion of deposits than credit growth. The following table gives detailed progress over a period of 15 years after nationalisation :

SCHEDULED COMMERCIAL BANKS : PROGRESS 1969 - 1984 41

Particulars	June 1969	June 1984
1. Total offices in India	8262	45332
Rural	1833	25372
Semi-urban	3342	9262
Urban	1584	5769
Metropolitan	1503	4929
2. Population per office (in thousands)	65	15
3. Deposits in India (Rs. crore)	4079	63852
4. Deposits as % of National Income (at current prices)	15.2 #	37.9 #
5. Total Bank Credit in India (Rs. Crore)	3599	43058
6. Bank Credit to priority sectors (Rs. Crore)	504 #	14834 #
7. Share of priority sector advances in gross bank credit%	14#	36.7#
8. Credit deposit Ratio %	77.5	67.4
9. Investment Deposit Ratio %	29.3	36.3

These figures pertain to March.

Thus expansion phase brought transformation of Indian banking by enlarging its geographical coverage penetrating into semi-urban and rural areas and gave it a socio-economic perspective by serving the priority sectors , which were hitherto neglected.

(C) CONSOLIDATION AND DIVERSIFICATION PHASE : (FROM 1985 TO 1990)

During the Expansion Phase, the growth of banking sector was phenomenal but fast expansion of

SOURCES:

40 & 41. Report on Trends and Progress Of Banking in India , Banking Statistics : Basic Statistical Returns, Reserve Bank Of India , various issues

branches and credit at concessional rate of interest started creating problems. The next phase, therefore, *consisted of consolidation and diversification approximately covering the period 1985-90.* The following important developments took place :

The branch expansion of commercial banks considerably slowed down as it was becoming unwieldy. However, thrust on coverage of rural areas continued. The number of commercial banks increased from 45,332 in June 1984 to 60,190 in 1991 but the major increase was accounted for by rural branches; their number increasing from 25,372 to 33,990 during the corresponding period. 42

The commercial banks acted in the direction of improving their organisational structure to cope with considerable increase in the number of their branches, toning up house keeping, customer service, credit management, recovery of dues, staff productivity, phased introduction of modern technology and profitability. Chakravarty Committee on the Working of the Monetary System (1985), (Sri S. Chakravarty as its Chairman), Working Group on Money Market (with Sri N.Vaghul as its Chairman),Goipuria Committee on Customer Service (with M.N.Goipuria of India Banks' Association as its Chairman) and Rangarajan Committee (with Sri C. Rangarajan, the then Dy. Governor and subsequently Governor, Reserve Bank Of India, as its Chairman) on computerisation were submitted ; most of the recommendations of these committees were accepted and these have been discussed in detail in the next Chapter.

Coupon rates on Government securities were raised (ranging from 5.50 % to 6.75% p.a. in 1978-79 to the range of 10.50% per annum to 11.50% p.a. in 1990-91). 182 days Treasury Bills were introduced as a new money market instrument. Interest rates on all money market instruments were deregulated. Discount and Finance House of India (DFHI) was set up as a specialised institution with the objective of providing liquidity to money market instruments and thereby helping to develop a secondary market. Banks were also permitted to issue instruments like *Certificate OF Deposits (CDs). The Commercial Paper (CP)*, a new instrument was also introduced enabling highly rated companies to access the market directly to raise money for their working capital requirements at market cost. The total outstanding issue of Certificate of Deposit by 37 major banks was Rs.2000 crore upto July 13, 1990. The outstanding CPs were over Rs. 155 crore as on August 10, 1990. An important development of 1980s was development of *Mutual Funds.*

The above developments show that the Indian financial market widened and deepened during 1980-90. This, alongwith other factors, contributed to economic development of India. The Sectoral real growth average during the Seventh Five Year Plan period (1985-90) was 3.4% in agriculture and allied activities, 7.5% in industry and total Gross Domestic Product at factor cost increased by 6.0%.

Thus during this phase, although expansion considerably slowed down in terms of number of branches of commercial banks, yet it served a useful purpose and attention was directed towards consolidating the gains of expansion by improving house-keeping, customer service, credit management, introduction of

SOURCES :

42. Reserve Bank Of India Bulletin , October 1990, Page 768

new instruments like certificate of deposits and commercial papers and development of mutual fund.

(D) PHASE OF LIBERALISATION AND REFORMS (1991 and onwards)

It is observed from the above that considerable expansion of branches of commercial banks after 1969 during expansion phase, introduction of new financial instruments and setting up of specialised institutions like DFHI in Money Market led to widening and deepening of the Indian financial system. Despite the overall progress made by the financial system, its operational efficiency was characterized by low profitability or even losses in several cases, high and growing non-performing assets (NPAs) and low capital base. The net profits of scheduled commercial banks during early 1990s had turned negative (-0.07%). The capital base- ratio of paid up capital and reserves to deposits of public sector banks around 2.85% in 1990-91 was much lower than international standards. The remedy was financial sector reform as a part of comprehensive economic reforms.

It led to setting up of Narasimham Committee on Financial Sector Reforms in August 1991, with Sri R. Narasimham, the then Dy. Governor , Reserve Bank Of India as its Chairman, in order to comprehensively examine all the aspects relating to organisation, structure, functions and procedures of the financial system. 43 The Committee submitted its Report in November 1991and its main recommendations included (a) reduction in Statutory Liquidity Ratio in phases to 25%, (b) operation of Cash Reserve Ratio in terms of monetary policy goals, (c) redefining the priority sector and reducing the target to 10% instead of the present 40%, (d) phased de-regulation of interest rate but with adequate caution, (e) Capital Adequacy Ratio of 8% to risk-weighted assets, (f) bifurcation of investment portfolios of banks into 'current' and 'permanent', (f) classification of loan assets into standard, sub-standard, doubtful and loss assets, (g) establishing Special Recovery Tribunals, (h) setting up of Assets Reconstruction Fund, (i) entry of private and foreign banks, (j) abolition of Branch Licensing Policy and (k) computerisation of branches to improve customer service and efficiency of banks. All the recommendations of the Committee have been accepted and implemented except (a) reduction in priority sector lendings target to 10% due to imperfections in the credit market and importance of those sectors in the economy and (b) establishment of Assets Reconstruction Fund (ARF) as it was felt that the concerned banks can better follow up their bad debts. In view of crucial importance of the matter, we have devoted third chapter for banking sector reforms

1.2.3 DEVELOPMENT OF MONEY MARKET IN INDIA

The Indian Money Market suffered from several drawbacks like being narrow and having a small number of participants, small number of instruments and regulated rates of interest. Several measures were,

SOURCES:

43. Report of the Committee on the Financial System , Reserve Bank Of India , November 1991

therefore, taken including setting up of two Committees (a) Committee to Review the Working of the Monetary System 44 headed by S. Chakravarty and (b) Working Group under the Chairmanship of Sri N. Vaghul, Chairman ICICI 45 . Chakravarty Committee submitted its Report in April 1985 and Vaghul Committee submitted its recommendations in January 1987. In the light of the recommendations of the above Commitees, the following steps were initiated to develop Money Market:

(i) 182-day Treasury Bills with flexible rates had already been introduced in November 1986.

(ii) Certificate of deposit and commercial paper as money market instruments were introduced in March 1989 and January 1990 respectively.

(iii) Discount And Finance House of India (DFHI) was set up as a specialised money market institution with the objective of providing liquidity to money market instruments and thereby helping to develop a secondary market.

(iv) Inter Bank Participation Instruments were introduced in middle 1989.

(v) Interest rates on inter-bank call money market and other money market instruments were deregulated in May 1989.

(vi) Money Market Mutual Fund (MMMF) Scheme was introduced in April 1991 to broadbase the money market by entry of more participants as also for development of secondary market.

(vii) Auction system of 364-day treasury bills and 91-day Treasury Bills were introduced in 1992-93. With the introduction of auction system, interest rates on Government borrowing instruments were closely market related.

(viii) In order to facilitate primary dealers (PDs) to have access to short term borrowings, RBI allowed PDs in September 1996 to issue CPs.

(ix) Subsequent to the relaxation in the norms for setting up of MMMF in December 1995, 8 banks / financial institutions / private sector mutual finds were permitted to set up MMMFs.

Thus money market in India has achieved fast development due to the above initiatives taken by Reserve Bank Of India.

SOURCES:

44. " Report of the Committee to Review the Working of the Monetary System ", dated the 10th April 1985, Sri Sukhamoy Cakravarty as Chairman , Reserve Bank Of India.
45. " Report on the Working Group on the Money Market ", dated January 13, 1987 with Sri N. Vaghul as its (Chairman), Reserve Bank Of India.

1.2.4 DEVELOPMENT OF CAPITAL MARKET IN INDIA

(a) Primary Market :

Indian Capital Market was subdued till 1970s. It picked up in 1980s due to healthy growth in industrial sector , relaxation in terms and conditions of debenture issues, encouragement to Public Sector Undertakings to float bonds at relatively high yields, liberalisation of investment facilities to Non-Resident Indians in Indian companies and fiscal concessions on investment in company shares. Specialised institutions like Securities & Exchange Board Of India (SEBI, a regulatory body), CRISIL, CARE and ICRA (credit rating agencies), Over The Counter Exchange Of India (OTCEI, screen based stock exchange) and Mutual Funds were also set up. Other initiatives included opening of Indian Capital Market for investment by the Foreign Institutional Investors (FIIs) in September 1992 and allowing the Indian companies to raise resources abroad through Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs) after obtaining specific approval of Government Of India. 46

During the eighties and nineties (upto 1995-96), mobilisation of funds by the primary market has shown significant increase as compared with the incremental aggregate deposits of Scheduled Commercial Banks (SCBs) as would observed from the following table: 47

Asset Intermediation by Banks and Capital Market

Rs. Crore

Period (1)	Incremental Aggregate Deposits Scheduled Commercial Banks (2)	Total Mobilisation in Primary Market * (3)	(3) as a % of (2)
1970-71 to } 1979-80 }	26,731	897	3.4
1980-81 to } 1989-90 }	1,35,200	30,668	22.7
1990-91 to 1995-96	2,66,860	1,50,504	56.4

* includes only private sector in period I, PSU Bonds since 1985-86, Government Companies including banks and financial institutions since 1991-92 and data on private placement (both private and public sectors) since 92-93.

SOURCES:

46 & 47. " Fifty Years of the Indian Capital Market (1947-97) ", Misra B.M. Reserve Bank Of India Occasional Papers, Vol. 18 Nos. 2 &3 June and September 1997.

The above data shows growing importance of capital markets in India vis-a-vis assets intermediation by banks.

(b) Secondary Market

The growth of primary market depends upon the development of secondary market (also known as Stock Market) as it provides liquidity support. Reforms in the secondary market in India focused on improving transparency, integrity and infrastructure. The Depositories Act 1966 and SEBI (Depositories and Participants) Regulation 1996 laid the foundation of the framework for minimising the problems associated with the handling of securities. The following table 48 shows the growth of Secondary Market in India :

Growth of Secondary Market in India

Year	No.of Stock Exchanges	No. of Listed Companies	Market Value of Listed Capital (Rs. crore)
1980 (December)	9	2265	6,750
1990 (March)	19	5968	55,406
1996	22	9,730	7,67490

In order to develop an efficient and vibrant secondary market for Government securities, Securities Trading Corporation of India (STCI) commenced operations from 27th June 1994. During 1995-96 and 1996-97, fresh initiatives were taken to further the link among gilt, money, capital and foreign exchange markets and to promote the retailing of Government securities by establishment of a system of *primary dealers* (PDs)and laying down of guidelines for setting up Satellite Dealers(SDs).

With the above developments, Capital Market is being integrated with other segments of financial market, which is essential to ensure healthy growth and discouragement of speculative tendencies.

1.2.5 NON - BANKING FINANCIAL COMPANIES

The Indian economy is passing through a period of rapid financialisation. These days a wide range of financial institutions intermediate through a number of customer-friendly financial products. The segment consisting of Non-Banking Financial Companies (NBFCs) has made good progress in recent years.

SOURCES:

48 Ibid. Same as item No. 47

NBFCs undertake a wide spectrum of financial activities There are broadly eight types of NBFCs in India e.g. equipment leasing companies, hire purchase finance companies, loan companies, investment companies, mutual benefit finance companies (Nidhis), miscellaneous non-banking companies, residuary non-banking companies and housing finance companies. They have influenced the directions of savings and investment. Thus, from both the macro economic perspective and structure of the Indian financial system, the role of NBFCs is quite important. Their emergence and growth could be traced to the need for provision of finance to the activities, which were not served by the organised banking system as also to a class of customers whose demands were not fully met. 49

The comparative data of the growth of aggregate deposits of Scheduled Commercial Banks and Non-Banking Companies (both NBFCs and Non-Banking Non Financial Companies) during 1991-96 is given below:

Growth in Aggregate Deposits of Scheduled Commercial Banks 50
and Non-Banking Companies : 1991-96
(Rs. crore)

Year End March	Scheduled Commercial Banks (SCBs)	No. of Reporting Companies	Deposits with Non-Banking Companies: Exempted Borrowings	Regulated Deposits	Total Deposits	Rate of change (Percent): SCBs	Total NBC Deposits	Regulated Deposits as % of SCBs Deposits
1991	2,04,733	10,127	37,326	6,747	44,073	--	--	3.3
1992	2,30758	11,278	43,688	7,496	51,184	12.7	16.1	3.2
1993	2,74,562	11,010	1,38,919	9,177	1,48,097	19.0	189.3	3.3
1994	3,24,720	11,270	1,62,578	23,202	1,85,780	18.3	25.4	7.1
1995	3,76,011	10,725	2,11308	37,295	2,48,604	15.8	33.8	9 9
1996*	4,20,449	12,530	2,41,864	53,480	2,95,344	11.8	18.8	12.7

Deposit figures of SCBs are as on March 31 each year and is exclusive of RRB deposits. * Provisional
Figures upto 1994 do not include deposits of Residuary Non-Banking Companies

The above table shows one significant point and that is faster rate of growth of NBCs deposits as compared to Scheduled Commercial Bank Deposits during 1991-96, which is basically due to higher

SOURCES:

49. Ibid., Chakravarty Committee Report Page 91

50. Reserve Bank Of India , Bulletin , December 1997

interest rate offered by them and their vigorous marketing efforts.

With a view to protect depositor's interest several steps have been taken viz. the registered NBFCs are required to achieve a minimum capital adequacy ratio (CAR) of 6% of their risk weighted assets by March 31, 1995 and 8% by March 31, 1996. The CAMELS Approach (Capital Adequacy, Asset quality, Management, Earnings liquidity and Systems) has been designed for on-site inspection process towards examining intensively the assets of NBFCs, besides their liabilities. A suitable off-site reporting system with emphasis on profitability and balance sheet related parameters has been introduced to exercise intensified surveillance over the NBFCs having assets of Rs. 100 crore and above. External auditors will also be used as special vehicles: they will be asked to certify important returns of NBFCs. 51

1.2.6 ROLE OF SPECIALISED DEVELOPMENT FINANCIAL INSTITUTIONS

The Specialised Development Financial Institutions (DFIs) were established to resolve the shortage of long term investments and to disseminate skills necessary to assess investment projects and borrower's credit -worthiness in the specified segments. Working Group 59 appointed by Reserve Bank Of India under the Chairmanship of Sri S.H.Khan to examine the role of DFIs and banks in the emerging environment, in its Report dated April 24, 1998, has opined that there is a need to move progressively towards universal banking and the development of a suitable regulatory framework for the purpose.

All India Financial Institutions comprising of Development Finance Institutions like IDBI, IFCI, ICICI, SIDBI, IRBI, SCICI and IFCICI and Investment Institutions like LIC, UTI and GCI have an important role to play. They undertake important activities like providing term finance, underwriting facilities, revival and revitalising sick units, financing of large, medium and small scale industries and merchant banking business etc. Most of the Development Finance Institutions raised resources recently e.g. rupee resources were raised by way of bonds/debentures by IDBI and IFCI 1996-97. To face the emerging challenges in the liberalised environment, SCICI Ltd. was merged with ICICI Ltd. in April 1997. The Industrial Reconstruction Bank Of India Ltd. was converted into a Company known as Industrial Investment Bank Of India Ltd. (IIBI) in March 1997. SIDBI has relaxed norms under their special schemes to facilitate greater flow of funds to industrially backward areas. ICICI expanded fee-based corporate advisory services to facilitate creation of better projects. It initiated efforts in areas like public sector restructuring and infrastructure projects. It also entered into business oriented activities from simple revival of sick units and expanded its merchant banking activities.

SOURCES:

51. Reserve Bank Of India Newsletter dated December 15, 1997 Vol. 23 No. 23 and Reserve Bank Of India Bulletin December 1997

With the setting up of new Development Financial Institutions and promotional role undertaken by them in a bigger way, their financial assets of have grown at a faster rate than banks specially during 1981-91 as will be observed from the following table: 52

Financial Assets of Banks and Financial Institutions

Institutions	1981	1991	1996	1997
1.Banks(Scheduled Com. Banks, Non-SCBs, State Coop. Banks)	46,987	2,32,786	5,08,652	5,64,789
2. Financial Institutions (All India Term Lending Institutions, State Level Ins.,Inv. Ins. & others)	16,650	1,22,655	2,77,864	3,22,952
3. Aggregate	63,637	3,55,441	7,86516	8,87,741
4. % 1 to 3	73.8	65.5	64.7	63.6
5. % 2 to 3	26.2	34.5	35.3	36.4

The ratio of assets of FIs to the total financial assets increased from 26.2% in 1981 to 34.5% in 1991 due to setting up of new FIs during the decade. Other factors for the growth have been significant growth in assets of term lending institutions 23.4% in 1996-97 on the top of a rise of 15.9% in 1995-96. Financial assets of the Investment Institutions too recorded a growth of 10.2% in 1996-97 and 9.2% in the previous year.

1.2.7 MACRO - ECONOMIC SETTING

Healthy development of financial system is thus conducive for economic development. Similarly development of financial system needs a sound macro-economic setting and framework conducive with real growth and price stability. While financial reforms succeeded in Malaysia and South Korea and to some

SOURCES :

52. Report on Trend and Progress Of Banking in India 199-97 (July-June) Page 184

extent Indonesia but failed to produce desired results in Argentina, Chile and Uruguay. Failure to maintain relative price stability in the face of deregulation in these countries left the financial system saddled with a large proportion of non-performing assets. Rising prices vitiate the atmosphere for promotion of savings and allocation of investment . It affects adversely those who have no hedges against inflation and poor section of the society is worst hit. The average annual inflation rate measured in terms of variation in Wholesale Price Index (WPI) in India has gone down to single digit for the last two years as would be observed from the following data :

Annual Inflation (Percent) 52 weeks average (53)

1992-93	10.1
1993-94	8.4
1994-95	10.9
1995-96	7.8
1996-97	6.4

Professor Paul Kruginan states that " Zero inflation may not be a good thing even in the long run. Better adopt a long run target fairly low but not zero inflation, say three-four percent. This is high enough to accommodate most of the real wage cuts that markets impose." Thus a modest price rise imposes a reasonable sacrifice with incentive to invest. But high inflationary pressure has adverse effects both on savings and investment and hence adversely affects development process besides imposing the problems of distributive justice.

1.2.8 INTERNATIONAL SCENARIO

Liberalisation and reforms have facilitated global integration of the markets of our country. Funds are now transferable nationally and internationally with new and innovative financial instruments. These developments have been supported by better tele-communication links and information system between Indian and foreign markets. Foreign banks have 180 branches in India. Indian banks are operating in 33 countries with State Bank Of India having the largest share. The net NRI deposits in India increased from 944 million US$ in 1995-96 to 3,439 million US$ in 1996-97. The comparative position of foreign investment in India is given below: 54

SOURCES:

53. Economic Survey, Government Of India and Report on Currency and Finance 1996-97 Volume I RBI.

54. Report on Currency and Finance, Volume I 1996-97, Reserve Bank Of India

Foreign Investment in India (US million $)

	1993-94	1996-97
Foreign Direct Investments	586	2,696
Portfolio Investment	3,649	2,864
Total	4,235	5,560

But there is a lesson to learn from the recent Asian Currency Crisis, which emanated from Thailand and spread to Philippines, South Korea, Malaysia and Indonesia. The immediate cause of crisis in Thailand was malalignment of exchange rate. The debtors in these countries did not hedge their liabilities as they believed that that the fixed exchange rate would not change. These countries also had a sharp increase in their short term liabilities. The troubled Asian countries were bailed out by the International Monetary Fund (IMF), which required them to restructure their weak banking and financial systems and follow sound macro economic policies.

1.2.9 GROWTH EXPERIENCE IN THE INDIAN ECONOMY

In order to examine the impact of the development of financial sector on economic development in India, we shall examine the causality of the Sectorwise and Assetwise distribution of investment and Sectorwise trend growth rates duly supported by distribution of household financial savings, which is the largest surplus sector in the Indian economy. P. Ray and D. Bose 55 conducted a study on the inter-temporal behaviour and sectoral composition of 3 related economic variables viz. growth of real domestic product, saving and capital formation in the Indian economy during 1950 / 51 to 1995 / 96. Four tables prepared by them are given below:

First table relating to Gross Domestic Saving Rate and its 3 components i.e. household saving, private corporate saving and public corporate saving and thereafter the total Gross Domestic Saving is given below:

SOURCES:

55. " *Growth , Saving and Investment in the Indian Economy* ", Ray Partha, Bose D. Reserve Bank Of India Occasional Papers Vol. 18 Nos. 2 &3 June and September 1997. pp. 104 - 137.

Nominal Gross Domestic Saving Rate and its Components 56

(As % of GDP at current market prices)

Particulars	1950-51 to 1967-68	1968-69 to 1975-76	1976-77 to 1978-79	1979-80 to 1984-85	1985-86 to 1992-93	1993-94 to 1995-96
Household Saving	8.4 (70.9)	11.7 (72.2)	15.8 (72.2)	14.3 (72.2)	17.1 (79.4)	19.2 (78.5)
Private Corp. Saving	1.3 (10.7)	1.5 (9.4)	1.4 (6.6)	1.7 (8.6)	2.4 (10.9)	3.9 (15.8)
Public Sec. Saving	2.2 (18.4)	3.0 (18.4)	4.6 (21.2)	3.8 (19.2)	2.0 (9.7)	1.4 (5.7)
Gross Domestic Saving	11.9	16.2	21.8	19.8	21.5	24.5

(Note: Figures in brackets are percentage shares in gross domestic saving)

The above table shows that Gross Domestic Saving has increased from 11.9% during the period 1950-51/ 1967-68 to 24.5% during the period 1993-94 / 1995-96 i.e. over a period of 45 years. The largest contributor has been the household sector accounting for 19.2% of Gross Domestic Saving and 78.5% of the GDP during 1993-94 to 1995-96.

The second table relates to Nominal Gross Saving Rate under various heads:

Distribution of household financial savings (net) 57 (%)

Particulars	1954-55 to 1967-68	1968-69 to 1975-76	1976-77 to 1978-79	1979-80 to 1984-85	1985-86 to 1992-93	1993-94 to 1995-96
1. Currency	25.3	22.4	19.2	17.3	14.3	15.1
2. Net Deposits	18.2	27.2	42.6	31.5	24.9	31.8
3. Shares and Debentures	12.9	4.9	3.3	5.6	14.4	11.1
4. Net claims on the Government	8.7	-3.1	1.8	11.8	12.9	9.6
5. Life Insurance Funds	11.0	13.4	9.7	9.9	10.2	11.3
6. Provident & Pension Funds	23.9	35.1	23.3	24.0	23.3	21.1
Total Household Financial Savings (net)	100.0	100.0	100.0	100.0	100.0	100.0

Analysis of the household savings shows declining preference for currency except marginally in the last block 1993-94 to 1995-96. The growing preference initially was for the banking sector i.e. in late seventies. In eighties the preference was for capital market due to emergence of mutual funds and confidence reposed by the household in this sector. Savings schemes with tax benefits have also attracted the household sector.

The third table showing sector-wise distribution of investment is given below: 58

Sectorwise Distribution of Investment

(As percentage to GDP at current market prices)

Item	1950-51 to 1967-68	1968-69 to 1975-76	1976-77 to 1978-79	1979-80 to 1984-85	1985-86 to 1992-93	1993-94 to 1995-96
1. Household	5.9 (43.4)	8.1 (45.7)	9.7 (46.2)	7.8 (35.4)	8.8 (36.8)	8.5 (35.3)
2. Private Corporate	2.4 (16.7)	2.6 (14.3)	2.0 (9.7)	4.0 (18.2)	4.9 (20.8)	6.9 (28.9)
3.Public Sector	5.8 (39.9)	7.2 (40.0)	9.3 (44.0)	10.2 (46.3)	10.1 (42.4)	8.5 (35.7)

Note: Figures in brackets are percentage to Gross Capital Formation

Public sector played a crucial role in the first phase in the context of economic planning adopted by the country. Private sector investment started picking up from eighties and has crossed 25% of GDP in the post reforms phase.

The industry-wise trend growth rates are given in the following table :

SOURCES:

56 to 58. Same as item No. 55

Industry-wise Trend Growth Rates 59

Sectors	1950-51 to 1995-96	1950-51 to 1964-65	1965-66 to 1975-76	1976-77 to 1991-92	1992-93 to 1995-96
1. Agriculture & Allied	2.4	2.5	3.1	2.9	2.9
2. Industry	5.6	6.8	4.2	6.4	10.1
3. Services	4.9	4.8	3.8	5.8	7.5
4. GDP at factor cost	4.0	3.9	3.6	4.9	6.8

From the above analysis and also conducting the causality analysis among Savings, Investment and Growth and checking the pattern of impulse response, Ray and Bose have drawn the following important conclusions: 60

(i) Growth experience of Indian economy has been beset with a number of crises. While disregarding the crisis years, the Indian growth has followed rather a smooth upward trajectory.

(ii) The phasing of saving and capital formation of the economy matched reasonably well, with the nineties ushering a new era. However, it is premature to decide whether it is a permanent feature.

(iii) A reasonably close correspondence (not necessarily a one-to-one variety) was found between the growth experience of the economy on the one hand, and saving and capital formation on the other.

(iv) In resolving the riddle of low growth and high saving/capital formation, they found that productivity performance of the Indian economy has not been a satisfying one.

SOURCES:

60. " Growth , Saving and Investment in the Indian Economy ", Ray Partha, Bose D. Reserve Bank Of India Occasional Papers Vol. 18 Nos. 2 &3 June and September 1997. pp. 104 - 137.

(v) As a possible clue to the above riddle, they found that the performance of the Indian public sector has been rather poor in terms of its contribution to both growth and saving

(v) In the policy area, the impact of growth to saving has been found to be more prominent than that of saving to growth and calls for breaking bottlenecks to growth in order to get rid of savings constraint.

1.2.10 CONCLUSION

Thus it has been established by the theoretical analysis, empirical studies and causality analysis that financial sector plays a crucial role in economic development of a country. The intermediation techniques of financial sector help in channelising funds from the surplus sector to the deficit sectors. The efficiency of intermediation depends on the width, depth and diversity of the financial system. The increased geographical and functional coverage of financial institutions, increase in the array of financial instruments and growth of financial markets are crucial for mobilisation and channelisation of savings to the most productive sectors of the economy. Financial sector and real sector are intertwined and growth of one leads to the growth of the other sector. Thus both the sectors are symbiotic.

The Indian banking system has grown phenomenally in terms of geographical coverage and spread to rural hinterland and also the far flung and backward areas. It has, therefore, been possible to mobilise deposits from these otherwise unexplored areas. Bank deposits as a percentage of Gross Domestic Product (GDP) at current prices has increased from 10.5% in June-end 1951 to 43.2% in June-end 1996. The banking system has also shown considerable ability in meeting the needs of agriculture, industry and trade all over the country and share of priority sector advances to total advances of banks increased from 14% in June 1969 to 41.7% of net bank credit in March 1997.

Indian capital market also witnessed growth in 1980s and 1990s as has been indicated earlier. Several factors have contributed to this growth viz. financial liberalisation, adoption of market oriented approach, entry of new institutions like Securities & Exchange Board Of India (SEBI, a regulatory body), CRISIL, CARE and ICRA (credit rating agencies), Over The Counter Exchange Of India (OTCEI, screen based stock exchange) and Mutual Funds. The investors' confidence increased due to the measures initiated by the Government and SEBI and buoyancy in the capital market. The Indian Capital Market was opened for investment by the Foreign Institutional Investors (FIIs) in September 1992 and the Indian companies were allowed to raise resources abroad through Global Depository Receipts and Foreign Currency Convertible Bonds (FCCBs) after obtaining specific approval of Government Of India.

Money market in India has also become more active and resilient due to introduction of new instruments like commercial paper, certificate of deposits and money market mutual funds, increase in the

number of participants and deregulation of interest rates on money market instruments. Setting up of Discount and Finance House Of India (DFHI) as a specialised money market institution is also helping in development of secondary market. The Government securities market is also developing and rate of interest on Government securities is more market related. In order to develop an efficient and vibrant secondary market for Government securities Securities Trading Corporation Of India (STCI) has been set up.

A series of reforms over the last 7 years have increased flexibility and responsiveness of the financial sector and promoted its integration. A process of liberalisation, deregulation, capital adequacy, income recognition and assets classification norms have been initiated to impart greater flexibility, economic viability and operational efficiency of financial institutions. An effective macro-economic framework is being maintained and inflation is under control. The impact of international market on the financial sector has been carefully planned and developed.

The above developments have also contributed to growth in the real sector in the Indian economy. In a study on the inter-temporal behaviour and sectoral composition of three related economic variables viz. growth of real GDP, saving and capital formation for the Indian economy over the period 1950 / 51 to 1995-96, it is, inter alia, observed that there has been a distinct jump in India' growth since the early nineties. The rate of economic growth (GDP at factor cost) was 7.2% in 1994-95 , 7.1% in 1995-96 and 6.8% in 1996-97 (estimated by CSO). The Eight Plan has ended with an average growth of 6.5% p.a., 0.9% higher than the target of 5.6% and 0.5% higher than VII Plan. The average growth rate of 7% during the last 3 years, places India among the top 10 performers in the world during this period. In many ways, the financial sector has helped in these achievements.

Chapter II

Growth of Commercial Banks in India

Outline

(iii) Bank Credit

(a)Sectoral Deployment of bank credit

(b) Priority Sector Lending

(1) Rural Credit

(2) Financing of Small scale industries

Sick SSI Units

(iv) Credit Delivery System in India

2.6. Profitability of banks in India in Pre-Reforms Phase

2.7. Conclusion

CHAPTER II

GROWTH OF COMMERCIAL BANKS IN INDIA

2.1 THEORETICAL BACKGROUND

Banks occupy a predominant position among the financial intermediaries in an economy but their role has been a matter of debate and of keen interest among the economists and policy makers. The difference centres around three issues (a) whether they are unique or one among other financial intermediaries, (b) the impact of asymmetrical information on the growth of banking (c) and whether the viewpoint of interventionists or liberalists or moderates (interventions in the economy or free play of market forces or combination of the two) is considered to be appropriate. These points are in addition to other latest developments like the emerging concepts of ' Universal Banking' and ' Narrow Banking' gathering momentum.

Fama 1 argued that in an ideal world of complete and perfect markets with full and symmetric information, there is no role for banks and financial intermediaries. As an ideal world can not exist, hence the existence and growth of banks all over the world has taken place. Other economists like Diamond 2 , Stiglitz 3 and Weiss held different views although they were also tackling the issue of information asymmetry. They argued that banks and other financial intermediaries have important advantages over securities market (capital market) in reducing information asymmetries that produces adverse selection problems. Thus they emphasised the importance of banks. Without going into details, it would suffice to say that banks enjoy a predominant position in the economy as they perform the following transformation mechanisms (Dr.Rangarajan) 4:

(a) Liability-Asset-Transformation : They accept deposits as a liability and convert them into assets such as loans and investments etc.

(b) Size-Transformation: Their specialist role comes to fore when they grant large loans on the basis of small deposits received by them. They thrive on economies of scale and their operations cost and

SOURCES:

1. " Banking In A Theory Of Finance", Fama E.F., Journal of Monetary Economics" 1980, 6, 39-57 "What Is Different About Banks", Fama E.F. Journal of Monetary Economics 1985, 11, pp 41-55
2. " Financial Intermediation And Delegated Monitoring", Diamond Douglas, 1984, Review of Economic Studies 51 (3) : pp 393-414
3. " Credit Rationing In Markets With Imperfect Information", Stiglitz A.E. and Weiss A. ,1981, American Economic Review 71, pp. 393-410.
4. Excerpts from Fourth SICOM Silver Jubilee Memorial lecture at Mumbai on July 29, 1996 delivered by Dr. C.Rangarajan, the then Governor of Reserve Bank Of India.

transactions cost stand reduced.
(c) Maturity Transformation : They offer to surplus and deficit units deposits and loans of different maturities as per their need and preference.
(d) Risk Diversification: They distribute risks by their expertise, market information. diversification and hedging.

Crane and Bodie 5 classify the functions of financial institutions as six core needs stated below:

(i) Making payments in order to facilitate exchange of goods and services,

(ii) Pooling resources to find large scale enterprises,

(iii) Transfer economic resources over time and across distance,

(iv) Managing risk such as insuring, diversifying and hedging,

(v) Price information such as interest rates and securities prices

(vi) Handling incentive problems that interfere in efficient business transactions such as loan covenants.

As regards the position of banks among financial institutions, the conventional monetary theory treats them as a separate category mainly due to the reason that bank liabilities, especially demand deposits, circulate freely as medium of exchange and are, therefore, included in definition of ' money '. Banks can be distinguished from other financial intermediaries in terms of the ' franchise value of banks ' 6 i.e. the special power conferred by the banking charter to issue liabilities that are accepted as a means of payment. Gurley and Shaw in their detailed study on the financial sector departed from this viewpoint and pointed out that banks are one among many of their kind and not a class by themselves. 7 Their contention is based on an approach that treats the theory of banking system as a part of a 'general theory of choice of optimum portfolios of assets and debts' by financial institutions of various kinds. 8 In addition to the above,

SOURCES:

5. " The Transformation Of Banking : Form Follows Function", Crane Dwight B. and Bodie Zvi, Harvard Business Review, March-April 1996. Vol. 74 No. 2 pp. 109-117

6. " Banks In Financial Intermediation: performance and Issues", Ajit D., Bangar R.D. Reserve Bank Of India Occasional Papers Vol. 18, Nos. 2 & 3 June and September 1977, pp. 303-349

7. " Financial Aspects Of Economic Development", Gurley John G. and Shaw E.S. AER September 1955, pp. 515-538

8. " Financial Intermediaries And Logical Structure", Patinkin Don , AER March 1961, pp. 95-116

banks play a catalytic role in creation of credit. They use their discretion, expertise and judgment in examining the loan proposals. Thus they try to maximise the allocative efficiency by sanctioning credit to the best loan proposals. The main argument of Fama 9 in favour of banks is that they have comparative advantage of having access to the information about the borrowers. The data bank and market reports serve as useful tools.

Cargill 10 focuses attention on commercial banks by saying " banks have many characteristics in common with other financial institutions; however, five distinguishing features require separate consideration of banks:

* First, banks are, by any reasonable standard, *the largest financial institution (as a group),*
* Second, the banks are the *most diversified of the financial institutions* as they deal with the broadest spectrum of surplus units and deficit units,
* Third, banks *dominate the issuance of demand deposits.* Demand deposits are presently the major type of transaction balance used in the economy.
* Fourth, the *cheque clearing mechanism* established by banks alongwith the cheque clearing facilities of the Federal Reserve System (Federal Reserve is the central bank of USA and it refers to the central bank of the country)."

Cargill, while highlighting the role of banks as a leading member of the family of the financial institutions, has not separated them to constitute a separate family. In view of crucial role assigned to banks, it is essential to examine their role and performance in our Indian economy.

2.2 STRUCTURE OF BANKING SECTOR IN INDIA

In India banks are the predominant financial intermediaries. The structure of banking system in the country has been shown by the following tree :

Banking Sector in India

- Reserve Bank Of India
- Commercial Banks
  - Public Sector Banks
  - Private Sector Banks
  - Foreign Banks
- Cooperative Banks

SOURCES:

9. " Banking In A Theory Of Finance", Fama E.F. Journal of Monetary Economics 6, pp. 39-57

10. " Money, the Financial System and Monetary Policy", Cargill Thomas F., Paretice Hall, New Jersey 1986 Edition, Page 81

2.3 RESERVE BANK OF INDIA

Reserve Bank Of India is the apex banking institution in India. The goals of the central bank are price stability and rapid economic growth through its promotional and regulatory mechanism. Reserve Bank Of India is one of the oldest central banks in the developing countries but quite young as compared to Bank Of England and Federal Reserve Board of America. Although Reserve Bank Of India started functioning from 1st April 1935 in terms of R.B.I. Act 1934, it was nationalised in 1949 under the Reserve Bank Of India (Transfer Of Ownership) Act 1948. In addition to the normal functions of (a) bank of issue, (b) banker to the Government, (c) bankers' bank, (d) lender of the last resort and (e) custodian of foreign exchange reserves, it performs following tthree important functions:

(i) Supervisory Functions

The legal and institutional framework for bank supervision is provided in the Banking Regulation Act 1949. Extensive powers of supervision including the power to inspect the banks have been conferred on Reserve Bank Of India by this Act. Supervision and control over banks in all major aspects were exercised by the Department of Banking Operations (DBOD) till the formation of Department Of Supervision (DOS) in 1993 in terms of the recommendations of the Committee on the Financial System. 11 DOS is an executive arm of the Board For Financial Supervision (BFS). constituted in 1994. DOS has been further bifurcated into two independent Departments : (a) Department Of Banking Supervision (DBS) to cater exclusively to supervision of banks and (b) Department of Non-Banking Supervision (DNBS) entrusted with the supervision of non-bank financial entities. 12

(ii) Controller of Credit

The power to control credit is vested in Reserve Bank Of India through the following mechanisms:

* Bank Rate (BR) :

Bank rate is the standard rate at which Reserve Bank Of India is prepared to buy or discount bills of exchange or commercial paper eligible for repurchase. The effectiveness of Bank Rate depends on need of the commercial banks for funds from RBI and extent of impact of bank rate on interest rates. In India Bank Rate had gone into disuse due to lack of eligible papers for rediscounting, undeveloped bills market and

SOURCES:

11. " Report of the Committee on the Financial System", dated November 8, 1991 headed by M. Narasimham, Reserve Bank Of India, pp. 83-88

12. " Report on Trend and Progress of Banking in India", 1996-97 Page 98, RBI

dominance of public sector, whose investment requirements may be interest inelastic.

In order to strengthen BR mechanism, all interest rates of advances from RBI with effect from 16th April 1997 have been specifically linked to BR. Following the one percentage point reduction each in BR each in April 1997, June 1997 and October 1997 bringing the BR to 9%, there is a corresponding reduction in deposits and prime lending rates (PLRs) of banks. 13 Thus BR has started serving as signalling rate as well as a reference rate. BR was raised by 2% on January 16, 1998 to arrest the decline in the value of rupee.

** Open Market Operations (OMO) :

Open market operations are conducted by a central bank mainly with a view to directly or indirectly affecting the reserves of banks by selling or buying Government securities. With the introduction of market related rates of interest on Government securities and broadening of Government securities market with several measures like introduction of new instruments and establishing necessary institutional framework like Discount Finance House of India (DFHI), system of primary dealers (PDs) in March 1995 and Satellite Dealers (SDs) in December 1996, the OMO mechanism is likely to be more effective as credit control mechanism.

*** Cash Reserve Ratio(CRR):

Under the Reserve Bank Of India Act, all scheduled banks are required to maintain with RBI every week a minimum specified average daily cash reserve of their Demand and Time Liabilities (DTL) in India outstanding as on last Friday. The RBI is empowered to vary CRR between 3% and 15% under the provisions of the above Act. The present status of this measure has been in examined in greater detail in Chapter III.

**** Statutory Liquidity Requirements (SLR) :

It is also known as supplementary reserve requirement or secondary reserve requirement primary being CRR. Under SLR, central banks normally require commercial banks to hold specified liquid assets such as Government securities against their deposit liabilities. The main objectives of SLR is to ensure solvency of commercial banks by compelling them to hold low risk assets to stipulated extent and in the process to create or support a market for Government securities. The rational use of this instrument, as implemented in the light of Narasimham Committee recommendations, has been dealt with in Chapter III.

***** Selective Credit Control :

Selective credit control measures include varying minimum margin requirements and stipulating credit ceilings etc. and are generally used to regulate credit for specific purposes in order to prevent speculative

SOURCES:

13. Reserve Bank Of India Bulletin, December 1997

holding of essential commodities. In India, these are imposed against selected commodities like sugar, Gur, Khandsari, wheat and edible oils etc.

(iii) PROMOTIONAL FUNCTIONS

Reserve Bank Of India has over a period of time played a promotional role for development of financial sector in India. It has taken several initiatives like introduction of Lead Bank Scheme, creation of Deposit Insurance and Credit Guarantee Corporation, development of co-operative sector, creation of National Bank for Agriculture and Rural Development (NABARD) and giving full fledged status to Unit Trust Of India (from earlier status of an Associate of RBI).

An important aspect of promotional function of RBI is creation of Rural Planning and Credit Department (RPCD) in 1992. The core activities of RPCD include (a) formulation of policies relating to priority sector advances, (b) assessment of quantitative and qualitative performance of commercial banks in lending to priority sectors and weaker sections and under Special Poverty Alleviation Programs and (c) monitoring the implementation of Lead Bank Scheme and Service Area Approach. In the post-nationalisation period RBI has played a key role in formulating policies for credit delivery system especially for weaker, neglected and priority sector so as to bring about socio-economic change. Thus Reserve Bank Of India, which is the apex banking institution in India, has been performing well its promotional and regulatory functions. The objectives of monetary policies of RBI have been price stability, planned expansion of bank credit, promotion of exports, development of priority sector like agriculture and small scale industries and distribution of credit in a proper manner. But prior to 1991, regulatory measures had become ' repressive ' and as such economic and financial sector reforms were introduced in 1991. The high level of CRR and SLR have been brought down to reasonable level. Bank rate is now being used as a signal and reference rate.

2.4 *GROWTH OF COMMERCIAL BANKS IN INDIA*

2.4.1. PRE - NATIONALISATION PERIOD

After independence, enactment of Banking Regulations Act 1949, nationalisation of Reserve Bank Of India in 1949, taking over of the undertaking of Imperial Bank Of India by State Bank Of India in terms of State Bank Of India Act 1955 and setting up of Deposit Insurance and Credit Guarantee Corporation in 1962 were important steps in the banking sector. After introduction of economic planning in 1951, the share of industry in total credit extended by Scheduled Commercial Banks (SCBs) rapidly rose from 34% in 1951 to 51% in 1961 and further to 67.5% in 1968. The share of trade in SCB credit faced a corresponding decline from 36% to 19% during the period 1951-68. Within the industrial sector, the bulk i.e. about 80% of bank credit went to Corporate Sector and only a small fraction to small scale industry. 14 The share of

SOURCES:

14. " Monetary Economics: Institutions, Theory and Policy", Gupta Suraj B. 1997, pp. 104-105

priority sector advances in total bank credit accounted for only 14% in June 1969. The SCB deposits increased from Rs.859 crore in 1951 to Rs. 4,079 crore in June 1969 i.e. more than four times increase. Their branches in rural areas were 1,833 out of total number of 8,262 accounting for 22% of the total. The total deposits of commercial banks accounted for 15% of National Income in June 1969. The Government considered the above performance as not subserving the social economic perspective and imposed 'social control' over banks and constituted National Credit Council on 22nd December 1967 for better coordination among commercial banks, cooperative banks and specialised agencies to ensure optimum and efficient allocation of resources with greater thrust on priority sector advances.

2.4.2. NATIONALISATION OF BANKS AND POST-NATIONALISATION PHASE

But the Government was not satisfied with the achievements by 'Social Control' over banks. Hence nationalisation was the only option. The Statement of The Banking Companies (Acquisition And Transfer of Undertakings) Act 1969 read as under:

" The banking system touches the lives of millions and has to be inspired by larger social purpose and has to subserve national priorities and objectives; such as rapid growth in agriculture and small industries, and exports and raising of employment levels, encouragement of new entrepreneurs and development of the backward areas. For this purpose it is necessary for the Government to take direct responsibility for the extension and diversification of the banking services and for the working of substantial part of banking system."

For fulfilling the above objective, an Ordinance was promulgated on 19th July 1969 and 14 banks with deposits of Rs. 50 crore or more were nationalised. On 15th April 1980, 6 more banks were nationalised taking the total of nationalised banks to 20. In October 1993, New Bank Of India was merged with Punjab National Bank and number of nationalised banks stood reduced to 19.

Thus nationalisation was recognition of the potential of the banking system to promote broader economic objectives such as extension of geographical coverage to help in the process of deposit mobilisation and purveying credit to the neglected sectors. It was designed to make the system reach out to the small man in the rural and semi-urban areas and to extend credit to sectors hitherto neglected by the banking system and through positive affirmative action provide for such expansion of credit to agriculture and small industry in place of what was regarded as a somewhat 'oligopolistic situation' where the system mainly served the urban and the industrial sectors. 15 It is also known as a shift from 'class banking' to 'mass banking.' True to the expectations, commercial banks, in general, and public sector banks, in particular, have made rapid strides in geographical coverage, mobilisation of deposits, deployment of credit and priority sector lendings.

SOURCES:

15. Ibid. Narasimham Committee Report, Page 6

2.5 DIMENSIONS OF GROWTH OF COMMERCIAL BANKS IN INDIA

2.5.1 BRANCH EXPANSION

Branches are the centres for delivery of banking services. As the expansion of geographical spread of banking system was given top priority both as a facilitating factor for deposit mobilisation, on one hand, and for purveying credit, especially in the rural hinterland, focus of attention was on branch expansion. The number of branches of commercial banks increased from 8262 in June 1969 to 63513 in June 1997: more than seven-fold increase, as would be observed from the following table:

Structure of distribution of Commercial Bank Branches in India: 1969-1997 16

	End June 1969 Total	End June 1969 of which rural branches*	No. of banks	End June 1997 Total	End June 1997 Of which rural branches*
1. State Bank Of India	1,569 (19.0)	29.4	1	8803 (13.8)	46.9
2. Associate Banks of SBI	893 (10.8)	40.0	7	4192 (6.6)	33.1
3. Nationalised Banks	4,134 (50.0)	16.6	19	31,398 (49.4)	44.3
4. Public Sector Banks (1 + 2 + 3)	6,596 (79.8)	22.8	27	44,393 (69.8)	43.9
5. Indian Private Sector Banks	1,319 (16.0)	20.1	34	4,473 (7.0)	25.4
6. Foreign Banks	130 (1.6)	0.8	30	179 (0.2)	--
7. Non-Scheduled Banks	217 (2.6)	28.1	3	9 (0.01)	33.1
8. Regional Rural Banks	-- --	-- --	19	14,459 (22.7)	85.9
9. Total (4+5+6+7+8)	8,262 (100.0)	22.2	113	63,513 (100.0)	51.9

Note: (i) Figures in brackets indicate percentage to total number of branches (ii) * in %.

The following important features are noted from the above table:

(i) The total number of commercial banks branches increased from 8,262 in end-June 1969 to 63,513 in end-

SOURCES: 16. Report on Currency and Finance Volume II , RBI, various issues

June 1997 laying the foundation for business growth from untapped areas.

(ii) Of the total branches of commercial banks (including regional rural banks), 51.9% were rural branches in June 1997 as compared to 22.2% in June 1969. Thus share of rural branches to total branches has more than double during 28 years after nationalisation.

(iii) Branches of State Bank Of India accounted for 13.8% of total branches of commercial banks in March 1997 as compared to its share of 19% in June 1969. The reason for decrease in the share of its branches to the total was emergence of regional rural banks and their branches accounted for 22.7% of the total in June 1997. The share of rural branches to total number of branches of SBI significantly increased from 29.4% in June 1969 to 46.9% in June 1997.

(iv) Branches of nationalised banks increased from 4,134 in June 1969 to 31,398 in June 1997 but their share in the total branches marginaly decreased from 50% to 49.4%. Their share of rural branches significantly increased from 16.6% to 44.3% during the corresponding period.

(v) An important feature is emergence of Regional Rural Banks (RRBs) in 1985 and total number of their branches were 14,459 in 1997 accounting for 22.7% of the total commercial bank branches. Thus these banks, which are sponsored by the Public Sector Banks had a large expansion with a rural thrust and the percentage of their rural branches was 85.9% in 1997.

(vi) The number of branches of non-scheduled banks decreased from 217 in June 1969 to only 9 in June 1997. This is due to merger of some banks.

The bank group-wise / population group-wise distribution of commercial bank branches in India as on June 30, 1997 is given in the following table:

3774-10
4817

Bank-Group-wise Population Group-wise distribution of branches of Commercial banks in India as on 30th June 1997 17

Bank Group	Rural	Semi-Urban	Urban	Metropolitan	Total
State Bank Of India	4,130 46.9	2,405 27.3	1,337 15.2	931 10.6	8,803 100
Associate Banks of SBI	1,386 33.1	1,485 35.4	716 17.1	605 14.4	4,192 100
Nationalised Banks	13,902 44.3	6,491 20.7	5,915 18.8	5,090 16.2	31,398 100
Indian Private Banks	1,137 25.4	1,549 34.6	1,022 22.8	765 17.1	4,473 100
Foreign Banks in India	--	3 1.7	17 9.5	159 88.8	179 100
Non-Scheduled Banks	3 33.1	2 22.2	2 22.2	2 22.2	9 100
Regional Rural Banks	12,423 85.9	1,759 12.2	274 1.9	3 $	14,459 100
Total	32,981 51.9	13,694 21.6	9,283 14.6	7,555 11.9	63,513 100

SOURCES: 17. Reserve Bank Of India , Bulletin , December 1997 $ Nominal

It is observed from the above table that after Regional Rural Banks, which have the major thrust in rural areas, State Bank Of India occupies the second place as regards rural branches as percentage of total branches. Associates of SBI have the highest percentage of semi-urban branches i.e 35.4% followed by Indian private banks (34.6%). Foreign banks with their total 179 branches in India have the largest concentration of metropolitan branches i.e. 88.8% and they do not have any rural branch.

Another endeavour of banking expansion has been to remove the disparities in banking presence in different parts of the country. In June 1969, five states of Maharashtra, Tamil Nadu, Karnataka, Gujrat and Uttar Pradesh accounted for 53% of total number of commercial bank branches and share of other 27 States and Union Territories was 47%. In June 1997, the share of the first group of States declined from 53% to 43% and the share of the other group increased from 47% to 57%. 18 Thus banking presence improved in different parts of the country.

Other area of improvement due to branch expansion of commercial banks in India has been reduction in 'Population Served Per Bank Office' from 65,000 in 1969 to 15,000 in 1997. Thus density of the banking coverage has increased resulting in the fall of the number of the population served per office giving an opportunity to serve better.

In the wake of enthusiasm of branch expansion, viability consideration of banking was lost sight of resulting in declining viability of the banks. This issue has been examined in Chapter IV.

2.5.2 DEPOSIT MOBILISATION

The other indicator of the banking expansion has been the growth in the volume of bank deposits in relation to Gross Domestic Product (GDP). In 1969, deposits of commercial banks accounted for 13% of GDP which increased to 42.5% in 1990 and further to 43.2% in 1996. Growth of deposits has been a function of level of income and savings, on one hand and institutional factors, on the other hand. This also known as 'institutionalisation effect' as propounded by H.Patrick, 19 Lewis, 20 and U. Tun-Wai 21 Deposits are like building blocks on which structure of bank business is built up and as such banks launch special drive for mobilisation of deposits.

SOURCES:

18. The above data has been worked out on the basis of the table of State-wise distribution of commercial bank branches given in Statement No. 74 of the Report on Currency and Finance 1996-97 Volume II, Page 114

19. Ibid.

20. Ibid.

21. Ibid..

The total deposits and mix of deposits of the Scheduled Commercial Banks covering a period of about 47 years is given in the following table:

Deposits of Scheduled Commercial Banks 22
1950-51 to 1996-97 (as at the end of March) (Rs. Crore)

	1951	1969	1981	1991	1994	1995	1996	1997 *
1. Deposit (i + ii)	859	4,079	37,988	1,92,542	3,15,132	3,86,859	4,33,819	5,05,599
(i) Demand Deposits	283 (32)	1,824 (44)	7,798 (20)	33,193 (17)	56,572 (18)	76,903 (20)	80,614 (19)	90,610 (18)
(ii) Time Deposits	576 (68)	2,255 (56)	30,190 (80)	1,59, 349 (83)	2,58,560 (82)	3,09,956 (80)	3,53,205 (81)	4,14,989 (82)

* Provisional @ Includes Certificate of Deposits (Figures in bracket show % to total)

Deposit mobilisation has been phenomenal after nationalisation: nine times increase during 1969-81, five times increase during 1981-91 average annual growth of 40.7% during 1981-91, 21.2% during 1991-94, 27.8% in 1995, 12.1% in 1996 and 16.5% in 1997. The growth in deposits, in general, at an accelerated rate is attributable to higher real growth achieved by the economy, expansion of bank branches and growth of savings habits and household's preference for bank deposits as a savings medium. The above table also shows a growing preference for time deposits during the period 1969-1991 highest being from 56% in 1969 to 80% in 1981 and thereafter to 83% of total deposits in 1991. During 1992-97, it has hovered around 80% to 82%. The record shift in favour of time deposits has been contributed by several factors like increased contribution of household sector, spread of banking facilities largely in unbanked and underbanked areas, growth of banking habits, introduction of diverse deposit schemes 23 and increase in interest rates on term deposits during this period. As regards interest rates on deposits, RBI has been

SOURCES:

22. Report on Currency and Finance, Reserve Bank Of India, various issues Statistical Tables Relating to Banks in India ,RBI, various issues

23. "The banks have been offering diversified investment plans to the public..... janta deposits, insurance linked eposits, farmers deposits annuity or retiring deposits, monthly income plans, minors savings schemes,....housing deposits and recurring deposits. These Schemes have been backed up by new services , such as collecting deposits at the savers' door -steps , providing better payment facilities and convenient banking hours." Financial Institutions, Markets: Structure, Growth and Innovations , Bhole L.M., Tata Mc Graw-Hill Publishing Co. Ltd.New Delhi 1992, Page 103

regulating these rates since 1964. The structure of interest rates on deposits was rationalised and revised upwards e.g. for deposits of 1 year to 3 years increased from 7.50% to 8.5% in 1980-81 to 9% in 1985-96, to 10% in 1990-91, 11% in 1994-95 and to 12% in 1995-96 and thereafter it has been reduced to 10% in phases by 1996-97. 24 Within term deposits, share of deposits with maturity of more than 1 year increased from 40.7% of total deposits in 1969 to 71.7% by 1994. Another important feature is emergence of short term deposits since 1985 and short term deposits with maturity of upto 45 to 90 days now account for 13.3% of term deposits. At present shortest period of term deposit is 30 days. Maturity pattern of depositsof scheduled commercial banks is given in the following table:

Scheduled Commercial Banks- Maturity Pattern of Deposits 25

1969- 1994 (as at the end of March) *(Rs. Crore)*

Period of Maturity	1969 Amt.	1969 % of total	1980 Amt.	1980 % of total	1986 Amt.	1986 % of total	1991 Amt.	1991 % of total	1994 Amt.	1994 % of total
1. Upto 90 days {						}	9,217	8.1	25,737	13.3
2. 91 days & above { but less than 6 month {	456	20.2	810	4.7	2,670	5.5 }	5,897	5.2	13,772	7.2
3. More than 6 months but upto 1 year	882	39.1	478	2.8	1,861	3.9	7,003	6.1	15,056	7.8
4. More than 1 years but upto 2 years	198	8.8	{ 3,074	17.9 }	5,225	10.9	16,312	14.3	49,195	25.4
5. More than 2 years but upto 3 years	118	5.3	{	}	3,298	6.9	30,927	27.1	26,975	13.9
6. More than 3 years but upto 5 years	461	20.4	2,194	12.8	11,500	23.9	23,492	20.6	38,031	19.6
7. 5 years & above	140	6.2	10,616	61.8	23,503	48.9	21,234	18.6	24,855	12.8
TOTAL 1 to 7	2,255	100.0	17,172	100.0	48,057	100.0	1,14,082	100	1,93,621	100

SOURCES:

24 & 25. Report on Currency and Finance Volume II, Reserve Bank Of India

There was a sharp change in preference of surplus units for time deposits of 5 years and above from 6.2% in 1969 to 61.8% in 1980 and thereafter it started declining to 48.9% in 1986 to 18.6% in 1991 and to 12.8% in 1994. The swing was on account of a definite preference for liquidity due to fast changing market conditions and preference for other institutions and other instruments available in the financial markets including share market and non-banking financial companies. In order to have an idea of the comparative position, we shall now examine savings of the household sector in different financial assets given in the following table:

Savings of the Household Sector in Financial Assets 26
(at current prices) (Rs. Crore)

Item	1951-52 to 55-56	1969-70 to 73-74	1980-81	1991-92	1994-95	1996-97 @
1. Currency	163	2,501	1,625	8,157	15,916	13,553
	(14.9)	(19.8)	(13.4)	(12.0)	(11.3)	(8.9)
2. Bank Deposits	161	5080	5,550	17,880	53,200	58,364
	(14.7)	(40.3)	(45.8)	(26.2)	(37.8)	(38.2)
3. Non-Banking Deposits/	--	383	378	2,218	11,547	22,377
Deposits with Companies	--	(3.0)	(3.!)	(3.3)	(8.2)	(14.6)
4. Life Insurance Fund	131	1,323	915	7,003	11,370	15,692
	(12.0)	(10.5)	(7.6)	(10.3)	(8.1)	(10.3)
5. Provident & Pension	178	2,381	2,122	12,500	21,691	24,373
Fund	(16.3)	(18.9)	(17.5)	(18.3)	(15.4)	(15.9)
6. Claims on Govt.	310	262	712	4,904	13,360	11,987
	(28.4)	(2.1)	(5.9)	(7.2)	(9.5)	(7.8)
7. Shares & debentures	150	124	412	6,800	11,611	5,859
	(13.7)	(1.0)	(3.4)	(10.0)	(8.2)	(3.8)
8. Units of Unit Trust of India	--	90	31	9,087	3,908	446
	--	(0.7)	(0.3)	(13.3)	(2.8)	(0.3)
9. Trade Debt (Net)	--	460	373	-414	-1850	300
	--	(3.7)	(3.1)	(-0.6)	(-1.3)	(0.2)
Savings (Gross) of the household sector in financial assets	1,093 (100.0)	12,604 (100.0)	12,117 (100.0)	68,135 (100.0)	1,40,753 (100.0)	1,52,951 (100.0)

@ Tentative Estimate. Figures in brackets are percentage to total.

SOURCES:

26." Report on Currency and Finance 1996-97 Volume II", Reserve Bank Of India, Statement 11 Page 13 and "Chakravarty Committee Report ", Page 48

As a consequence of diversification of financial structure, the preference of households for holding currency has declined from 14.9% (1951-52 to 1955-56) to 8.9% (in 1996-97). Due to fast expansion of banks, there was a sharp increase in the share of bank deposits in household savings from 14.7% (1951-52 to 1955-56) to 45.8% in 1980-81. Bank deposits were the option for investment with depressed capital markets conditions in seventies. But late eighties saw a vibrant capital market and also emergence of mutual funds and these factors encouraged household sector investment in shares and debentures increasing from 3.4% in 1980-81 to 10% in 1991-92 and after further increasing to 10.2% in 1992-93, it started declining (8.2% in 1994-95 and 3.8% in 1996-97). The reasons are decline in investor's interest in equity market and falling sensex in the secondary market. Another strong factor is deposits with non-banking finance companies, which increased from 3% (1969-70 to 1973-74) to 14.6% in 1996-97. NBFCs offer higher rates of interest and adopt active market campaign. The share of net claims on Government increased from 2.1% (1969-70 to 1973-74) to 9.5% in 1994-95 due to tax concessions in some of the Schemes.

The Gross Total Savings in financial assets declined from a peak of 14.8% in 1994-95 to 10.9% in 1995-96 and recovered to 12.1% in 1996-97. Higher consumerism on account of products launched by multi-national companies had been strong factors leading to higher consumption pattern during 1995-96 and lower savings. But financial savings have picked up again in 1996-97. A wider array of bank deposit schemes meeting the investor's preferences combined with new dimensions of information technology is required to attract the customers to lodge their deposits with banks.

2.5.2.1 Certificate of Deposits (CD)

Certificate of deposits, introduced as a money market instrument, is also a source of large deposits for banks. But it is a high cost deposit. According to guidelines issued by Reserve Bank Of India in April 1997, the minimum size for the issue of CD to a single investor was reduced to Rs. 10 lac from Rs. 25 lac earlier. It was further reduced to 5 lac with effect from in October 1997. Reflecting easy liquidity conditions in the banking sector, the outstanding amount of certificate of deposits of scheduled commercial banks declined perceptibly from Rs. 16,316 crore for the fortnight ended March 29, 1996 to Rs. 12,134 crore for the fortnight ended March 28, 1997. Following lack of demand for funds and general decline in interest rates, the discount rate range on CDs declined substantially from 12.00 -22.25 percent for the fortnight ended March 29, 1996 to 7.00-15.75% for the fortnight ended March 28, 1997 and further to 7.30-12.50 percent for the fortnight ended September 12, 1997.

2.5.3 BANK CREDIT

Purveying credit is a significant function of the banking sector. Financial resources are scarce and have alternative uses. The banks have to ensure allocative efficiency so that credit is allocated to the most productive sectors of the economy. But the task is not easy. Stiglitz 27 and Weiss demonstrated that

SOURCES:

27. Ibid, pp. 393-410

informational asymmetries in debt market can lead to credit rationing as an equilibrating force. The informational asymmetries and consequent adverse selection problems can lead to adoption of riskier projects in the portfolios of banks. Hence this School of thought recommended an intrusive interventionist approach. As against this, Mckinnon 28 and Shaw led the liberal school and recommended for freeing the economy from administered interest rate regime so that market price i.e. interest and demand and supply of credit could act as an equilibrating force. A moderate approach recommends for liberalisation in the financial sector, of which banking sector is a very important part, but with proper macro economic setting and with introduction of prudential norms. We shall examine these aspects in the context of the Indian economy at appropriate places.

Some economists have put forward their viewpoint that banks lay emphasis on net worth of borrowers and collateral security as a safeguard against credit risks. This leads to preference for large and established borrowers and small firms, so to say, small entrepreneurs suffer. Mayer and Gertler observed existence of a long term relationship between banks and firms. While the large firms want a long term commitment for their projects, the banks are governed by profitability considerations. This leads to a long term relationship and profit is a deciding factor of availability of long term finance for firms. Gertler 29 says "..... the class of large firms consists of mature firms.." and "..... there may be informational economy of scale in lending to large firms, to the extent that lenders may find higher fixed costs of gathering certain critical data about small borrowers ....financial constraints are likely to have more impact on the real decisions about the individual borrowers and small firms than on large firms"

Kohli 30 has observed in her research paper that " in relative terms (as for example, small versus large industries) difference in size weighs with risk averse financial intermediaries which might be affecting credit availability to small borrowers.... A reasonable approach under the circumstances could be that such borrower firms (smaller and new) are supported through regulation of financial intermediaries if it was clear that the social gains to be had through special credit dispensation arrangements outweighed losses due to regulation."

2.5.3.1 Sectoral Deployment of bank credit

We shall examine the relevance of the above viewpoints in the Indian context. The Sectoral Deployment of Bank Credit outstanding is given in the following table:

SOURCES:

28 & 29. Ibid.

30. "Financial Structure and Aggregate Economic Activity : An Overview", Gertler M. , Journal Of Money, Credit and Banking , Volume 20 (3), August 1988, Page 588.

31. " Credit Availability and Small Firms", Kohli R., pp. 1-23, Reserve Bank Of India, Occasional Papers, Volume 18 No.1, March 1997

Sectoral Deployment of Scheduled Commercial Banks 32

Gross Bank Credit Outstanding (Rs. Crore)

	1972 June	1984 March	1995 March	1997 March
A. Gross Bank Credit (i)+ (ii)	5,480	40,454	1,96,985	2,49,408
	(100)	(100)	(100)	(100)
(i) Public Food Procurement Procurement Credit	542	4,030	12,275	7,597
	(9.9)	(10.0)	(6.2)	(3.0)
(ii) Non-Food Gross Bank Credit (A+B+C+D)	4,938	36,424	1,84710	2,41,811
	(90.1)	(90.0)	(93.8)	(97.0)
A. Priority Sector	1,208	14,834	64,161	81,988
(% to Gross Bank Credit)	(22.0)	(36.7)	(32.8)	(32.9)
Agriculture	439	6,133	23,983	30,874
	(8.0)	(15.3)	(12.2)	(12.4)
Small scale Industries	597	5,412	27,638	34,113
	(10.9)	(13.3)	(14.3)	(13.7)
Other priority Sectors	172	3,289	12,540	17,001
	(3.1)	(8.1)	(6.3)	(6.8)
B. Industry (Medium & Large)	3,730 *	14,964	74,672	1,00,025
	(68.1)	(37.0)	(37.9)	(40.1)
C. Wholesale Trade (other than procurement)		2,338	9,749	11,933
		(5.8)	(4.9)	(4.7)
D. Other Sectors		4,288	36,128	47,865
		(10.6)	(18.3)	(19.2)
E. Export credit included in item (ii) above for 95 & 97			25,051	28,588
			(12.7)	(11.5)

Data in brackets shows % to Gross Bank Credit except item No. G . Item G shows % to Net Bank Credit
* includes items C & D

The above table shows that there has been phenomenal increase in bank credit. It increased at an average annual rate of 53.2% during 12 year period 1972-84, 35.2% during 11 year period 1984-95 and 13.2% in two years period 1995-97. The increase in bank credit was due to higher demand for credit both by agricultural and industral sectors and the process was facilitated by newly opened branches. Non-food gross bank credit increased from 90.1 % in June 1972 to 97% in March 1997. The greatest share has gone to the priority sector increasing from 22% of gross bank credit in June 1972 to 32.9% of Gross Bank Credit in March 1997.

SOURCES:

32. Report on Trends and Progress of Banking in India , Reserve Bank Of India, various issues

Sectoral deployment of bank credit by commercial banks in major sectors for the last 4 years given in the following table:

Sectoral Deployment of Credit by Scheduled Commercial Banks 33

Particulars	March 18,1994	March 31, 1995	March 29, 1996	March 28, 1997
I Gross Bank Credit	1,56,857	1,96985	2,31,860	2,49,408
(a)Public Food Procurement credit	10.907	12,275	9.791	7.597
(b) Non-Food Gross Bank Credit	1,45,950	1,84,710	2,22,069	2,41,811
A. Priority Sector	53,880	64,161	73,329	81,988
B. Industry (Medium & large)	57,865	74,672	93,053	1,00,025
C. Wholesale Trade (other than food pr.)	7,330	9,749	11,980	11,933
Other Sectors	26,875	36,128	47,865	47,865

Gross Bank credit increased by 25.6% in March 1995 and by 17.8% in March 1996 over the previous year. But bank credit remained sluggish during 1996-97 and the expansion was only 9.6% during the year. Food credit declined by 22.4% in 1996-97 as compared with a decline of 20.3% during 1995-96. Expansion in non-food credit i.e. 10.9% in 1996-97 was sharply lower than expansion of 22.5% in 1995-96. The major slackness in credit expansion in 1996-97 was in industry and wholesale trade segment. During 1996-97, credit to industry recorded a lower growth of 7.4% as compared to 22.1% in 1995-96. Similarly bank credit to wholesale trade sector (excluding credit for food procurement) recorded a decline of -0.2% in 1996-97 as against a growth of 6.0% in the previous year. A major consolation in the credit situation is the increase in credit to priority sector by 43.9% in 1996-97 as compared with a rise of 24.5% in 1995-96. Among the various industries, credit to engineering and chemical industries, agro-based industries : such as cotton and jute textile, sugar and tea industries as well as gems and jewellery and leather industries received lower credit during 1996-97 as compared to the previous year. On the other hand, petroleum industry increased its access to bank credit in 1996-97 mainly due to rising oil pool deficit.

With the lower offtake of non-food credit coupled with 18.2% increase in bank deposits in 1996-97, the credit deposit ratio of banks declined from 58.6% in 1995-96 to 55.1% in 1996-97. Incremental

SOURCES:

33. Report on Trend and Progress of Banking in India , 1996-97 (July-June) , Reserve Bank Of India

credit expansion in 1996-97 was lower despite expansion of credit to petroleum companies increasing from Rs. 1,510 crore in 1995-96 to Rs.3,375 crore in 1996-97. A major factor underlying the sluggish credit growth is deceleration in industrial growth from 11.6% in 1995-96 to 6.6% in 1996-97. Moreover, risk-free Government securities with market related rate of interest also attract the banks to invest a higher proportion of their funds in Government and other approved securities than the prescription of SLR and this issue has been subsequently analysed in this chapter.

As regards sectoral deployment of credit, some economists contend that dependence of industries on bank finance is based to a great extent on their size. According to Gertler and Gilchrist 34 bank credit is special and not substitutable for small firms. They can not raise resources from the capital market and hence their dependence on banks for working capital funds. In India it is true that bank credit was skewed in favour of medium and large industries and even after 3 years of nationalisation in 1972, they accounted for 68.1% of total bank credit. But reversing the above trend, the post-nationalisation period policies had thrust on development potential rather than on security orientation. The main aim was to extend bank credit both geographically and functionally. Banks did not discriminate against small firms. In fact they laid more emphasis on small scale industries as a matter of policy. The share of SSI increased from 8.5% of net bank credit of public sector banks in June 1969 to 16.6% of their net bank credit in March 1997. The post-nationalization social bias of lendings has been described as supply-oriented by Tyagrajan 35 , Shetty 36 and Mujumdar 37 . The system laid more emphasis on need-based approach rather than on margins on valuation of stocks and collateral securities in respect of priority sector advances. It enabled weaker sections to avail bank finance specially under Government sponsored schemes. The sectoral spread of bank credit also improved from the erstwhile tilt towards medium and large industries. It is in this context, priority sector lendings assume critical role.

2.5.3.2 Priority Sector Lendings

The concept of priority sector was evolved in the late Sixties in order to focus attention on the need to ensure adequate credit facilities to certain neglected sectors of the economy particularly in the rural areas,

SOURCES:

34. " Monetary Policy, Business Cycles and the Behaviour of Small Manufacturing Firms" Gertler M. And Gilchrist S., Finance and Economic Discussions Series 93-94 Washington, Division of Research and Statistics, Division of Monetary Affairs , Federal Reserve Board, February 1993

35. " Expansion of Commercial Banking : An Assessment", Tyagrajan M. Economic and Political Weekly (1975), (10), 1819-24

36. " Performance of Commercial Banks Since Nationalisation of Major Banks: Promise and Reality, Shetty S.L., Economic and Political Weekly 13, Special No. 1407-51

37. " Structural Transformation in the Development of Credit : Some Implications", Mujumdar N.A. RBI Occasional Papers 3, pp. 97-113

where banks had hardly made their presence felt. In addition to rural credit, other priority sector areas include financing of small scale industries, retail trade, small business and housing finance etc. In addition to social orientation, these sectors are crucial for Indian economy. Agriculture sector provides raw materials for agro-based industries. Both agriculture and small scale industries are labour-intensive and provide employment to a very large number of people. The poverty alleviation programmes also aim at distributive justice so that poor and needy can be benefitted. Policy guidelines issued in 1974 to Public Sector Banks stipulated that by March 1979 they should extend credit to the priority sector to the extent of at least one-third of their total credit outstanding by March 1981. The target of priority sector lending was raised to 40% in October 1980 to be achieved by March 1985 and within the overall target a significant proportion should be allocated to the beneficiaries under the '20 Point Programme'. Within the target of 40% of priority sector, advances to weaker section was to be maintained at a level of 10% of net bank credit.

In November 1992, it was stipulated that each bank should target to attain a level of export credit of 10% of its net credit by the end of June 1993. For promoting exports, the target for export credit was raised in October 1996 to 12% of net bank credit to be reached by end March 1997. Banks having higher ratio of export credit were required to ensure that there is no shortfall in the ratio.

With a view to increase the flow of credit to agriculture, banks were advised to step up direct finance to agriculture so as to reach a level of 16% by March 1987, 17% by March 1979 and 18% by 1990 within the overall target of 40% for priority sector lending. Banks having a shortfall in achieving the sub-target of agriculture were advised by RBI in 1995-96 to contribute to the Rural Infrastructure Development Fund I (RIDF I) with a corpus of Rs. 2,000 crore, newly set up at NABARD, an amount equivalent to the amount of shortfall subject to a maximum of 1.5% of the net bank credit, which would be treated as priority sector lending.

Banks falling short of achieving the priority sector target were advised by RBI in 1995-96 to provide Rs. 1,000 crore on a consortium basis to the Khadi and Village Industries Commission (KVIC), on top of lending to the Handloom Cooperatives for the purpose of financing viable khadi and village industrial units on specified rate of interest, which would be reckoned as priority sector lending.

The private sector banks falling short of priority sector lending target of 40% of net bank credit as on the last Friday of March 1996 were required to deposit not later than August 31, 1996, 50% of the shortfall with NABAD / SIDBI for a period of 1 year at an interest rate of 8% per annum or for a period of 5 years at an interest rate of 11.5% per annum.

The priority sector advances of public sector banks steadily increased in post-nationalisation period in absolute terms and also in terms their share in total bank credit as would be observed from the data given in the following table : 38

SOURCES:

38. Reserve Bank Of India Bulletin, December 1997

Advances to the Priority Sector by Public Sector Banks

Particulars	Total Priority Sector Credit (Rs. in crore)	% to net bank credit
June 1969	441	14.6
March 1994 @	53,197	37.8
March 1995 @	61,794	36.6
March 1996 @	69,609	37.8
March 1997 $	79,131	41.7

@ Data are provisional $ inclusive of Rs 29.25 crore provided to RRBs by their sponsorer banks, eligible for being treated under priority sector advances

The increase in advances to priority sector by public sector banks during the post-nationalisation period has been phenomenal and in absolute terms advances to the aforesaid sector increased from Rs. 441 crore in June 1969 to Rs. 53,197 crore in March 1994 and consistently increased every year and amounted to Rs. 79,131 crore at March 1997. Their share in total bank credit has also substantially increased from 14.6% of total bank credit in June 1969 to 41.7% in March 1997 in conformity with the objectives of bank nationalisation.

It will be observed from the following table that private sector banks (old) have also not lagged behind public sector banks and even surpassed them in financing priority sector advances in terms of percentage to total credit in March 1997:

Advances to the Priority Sector by Indian **Private Sector Banks (Old)** 39

Particulars	Total Priority Sector Credit (Rs. in crore)	% to total bank credit
March 1995	4,064	30.0
March 1996	5,060	35.9
March 1997	6,074	42.5

SOURCES: 39. Same as for 38

In absolute terms advances to priority sector by Indian private sector banks (Old) increased from Rs. 4,064 crore in March 1995 to Rs. 6,074 crore in March 1997 and in terms of percentage to their total net bank credit it increased from 30% to 42.5% during the aforesaid period.

Advances to the Priority Sector by Indian Private Sector Banks (New) 40

Particulars	Total Priority Sector Credit (Rs. in crore)	% to total bank credit
March 1995	1,223	27.8
March 1996	2,623	38.3

The Indian private sector banks (new) are also required to fulfil the overall priority sector target of 40% of net bank credit. and other sub-targets as applicable to other public sector banks. Despite being new players in the financial market new private sector banks have also done well by achieving 38.3% advances of their net bank credit to priority sector in March 1997 increasing from 27.8% in March 1996.

In April 1993, foreign banks in India were advised to increase their priority sector advances from 15% of their net credit to 32% in March 1994. Within the enhanced target of 32%, two sub-targets of 10% each for advances to small scale industries and export sector were fixed. On November 4, 1996 the target for export credit for these banks was also raised to 12% of net bank credit within the overall target of 32% to be achieved by end-March 1997. The performance of foreign banks is given in the following table:

Advances to the Priority Sector by Indian Foreign Banks in India 41

Particulars	Total Priority Sector Credit (Rs. in crore)	% to total bank credit
March 1995 @	5,417	39.0
March 1996 @	6,129	37.1

SOURCES:

40 & 41. Reserve Bank Of India Bulletin, December 1997

The aggregate priority sector advances by foreign banks in India increased from Rs. 5,417 crore in March 1996 (39% of their net bank credit) to Rs. 6,129 crore in March 1997 (31.7% of their NBC). Thus foreign banks are also fully conscious of their responsibility of the socio-economic obligations.

Despite the above targets and achievements, difficulties are often encountered due to lack of coordination among the different agencies involved. Bank credit is only one of the inputs for priority sector lendings and it can only succeed if sufficient coordination among the developmental agencies at the district, block and even at lower levels were available. Lack of the aforesaid coordination and thrust on the targets sacrificing viability analysis of the credit proposals brought in its wake a decline in the quality of their loan portfolio. The remedial measures require, inter alia, a more careful scrutiny of the viability of the projects, a more realistic assessment of the credit absorption capacity of the borrowers' projects in the areas concerned, better training for the bank personnel and pre-sanction and post-sanction inspections so as to ensure proper end-use of funds and timely recovery.

(1) Credit to Agricultural Sector

Agricultural sector occupies an important position in Indian economy. It feeds the population of the country and provides raw materials for the agro-based industries. Agricultural credit market, however, differs from other markets. Besley 42 identifies two features that make rural credit markets different from other credit markets. Firstly, rural borrowers are not endowed with assets which could serve as a collateral. Land as a collateral has its serious limitations. Another feature is the risk of income shocks leading to defaults. These factors discourage the financial intermediaries to extend credit facilities to agriculture. Intervention in credit markets, especially with regard to rural credit markets, is a common feature and India is no exception. 43

In India one of the objectives of nationalisation of banks was to serve the credit needs of the rural sector in a better manner. Rural credit is, in fact, placed on three strong pillars :

* Expansion of rural credit structure,
** Directed Lendings in terms of targets,
*** Concessional rates of interest.

Regional Rural Banks (RRBs) are also an integral part of the structure created for expansion of rural credit , These banks were set up in terms of the recommendations of Narasimham Working Group 1985 44

SOURCES:

42. " How Do Market Failures Justify Interventions In Rural Credit Markets?" Besley T. 1994. World Bank Research Observer, Vol. 9 (I), pp.27-47
43. " World Development Report 1989: Financial Systems and Development", Oxford University Press, New York " The East Asian Miracle", 1993, Oxford University Press, New York
44. Working Group on Rural Banks, Chairman, 1985, Narasimham M., RBI

and a Multi-Agency Approach comprising of commercial banks, cooperatives and regional rural banks emerged.

RRBs were expected to combine a local feel and familiarity with the rural problems, which the cooperatives possessed and, on the other hand, degree of business organization and outlook of commercial banks. In order to create a level playing field in respect of priority sector dispensation, advances of RRBs to priority sector have been placed on par with commercial banks at 40% target. Crop loans given by RRBs amounted to Rs.1,330 crore in March 1996 constituting 18.8% of their total credit and term loans for agriculture amounted to Rs. 1,239 crore in March 1996 representing 16.4% of their total credit.

For ensuring overall economic development of the rural sector, it is imperative that timely and institutional credit at affordable rates is made available to the beneficiaries. The All India Rural Credit Survey (1954) in its Report advocated a well defined role for commercial banks in providing credit for agriculture in the areas like marketing, processing, storage and warehousing. Nationalisation of banks increased flow of credit to rural sector.

Public sector banks have played a major role in providing credit to agricultural sector Rural credit extended by these banks has increased substantially during the post-nationalisation period . The total advances outstanding to agricultural sector increased from Rs. 162 crore in June 1969 to Rs. 21,204 in March 1994 and further to Rs. 23,513 crore in March 1995, Rs. 26,351 crore in March 1996 and Rs. Rs. 31.012 crore in March 1997. As a percentage to net bank credit, it increased from 5.4% in June 1969 to 15% in March 1994 but declined to 13.9% in March 1995, recovering to 14.3% in March 1996 and 16.4% in March 1997. They have yet to make more efforts to achieve the target of 18% of net bank credit. Direct advances to agriculture constituted 13.7% of net bank credit of PSBs and the share of indirect agriculture finance was 2.7% of net bank credit. as would observed from the following table:

Advances to Agriculture by Public Sector Banks 45

Amount outstanding in Rs.crore

Year	Direct Agriculture Amount Out-standing	Direct Agriculture % to Net Bank Credit	Indirect agriculture Amount Out-standing	Indirect agriculture % to Net Bank Credit	Total Agriculture Amount outstanding	Total Agriculture Percentage to Net Bank Credit
June 1969	40	1.4	122	4.0	162	5.4
March 1994	19,255	13.6	1,949	1.4	21,204	15.0
March 1995	20,813	12.3	2,700	1.6	23,513	13.9
March 1996	22,892	12.4	3,459	1.9	26,351	14.3
March 1997	25,826	13.7	5,186	2.7	31,012	16.4

SOURCES:

45. Reserve Bank Of India , Bulletin December 1997

The reason for initial decline in the ratio of indirect agricultutal credit to net bank credit and thereafter slow progress is comparatively lesser credit absorptive capacity.

Advances to agriculture by old private sector banks have also improved during the post-nationalisation period as would be observed from the following table:

Advances to agriculture by Old Indian Private sector Banks 46

Amount outstanding in Rs. crore

Year	Direct Agriculture Amount Out-standing	Direct Agriculture % to Net Bank Credit	Indirect agriculture Amount Out-standing	Indirect agriculture % to Net Bank Credit	Total Agriculture Amount outstanding	Total Agriculture Percentage to Net Bank Credit
March 1995	722	5.3	94	0.7	816	6.0
March 1996	912	6.5	218	1.5	1,130	8.0
March 1997	1,130	7.9	335	2.3	1,465	10.2

As compared to Old Indian Private Banks, New Indian Private Banks have started their operations much later and as such their advances to agriculture constituted 6.5% of their net bank credit as compared to 10.2% by Old Private Banks in 1996-97. But keeping in view that they are mainly concentrated in metropolitan and urban areas, their performance is considered to be good. In any case, while achieving the target the main consideration has to be viability of advances.

In order to encourage research orientation in rural sector, in June 1994, banks were advised by Reserve Bank Of India to open at least one Specialised Agricultural Finance Branch in each state to adequately deal with high-tech agricultural finance, where they are convenors of the respective State Level Bankers' Committee (SLBC). 47

(2) Advances to Small Scale Industries

Small scale industries are an important segment of priority sector advances. SSI have certain inherent

SOURCES:

46 & 47. Reserve Bank Of India , Bulletin December 1997

advantages for a developing economy like India. Their capital intensity is lower and consequently they generate more employment opportunities. They widen the entrepreneurial base. They manufacture a wide variety of products ranging from simple to sophisticated ones. The SSI sector contributes 40 % to the gross turnover of the manufacturing sector in India. This sector accounts for 45% of the manufacturing exports and 34% of total exports. It provides employment to 16 million people. An Expert Committee was set up in 1995 (Chairman Sri Abid Hussain) 48 to recommend policy reforms and new policies for the development of small and medium enterprises to make them viable and efficient units in the light of technological changes and international competitiveness. The Committee in its Report submitted to the Government of India in January 1997 has recommended several measures/changes encompassing various facets of SSI sector e.g. adequate supply of credit, technological assistance and infra-structure. The Committee also recommended for raising threshold level of investment in plant and machinery to Rs.3 crore and setting up of specialised branches of commercial banks for SSI and Local Area Banks. Based on the recommendations of the Committee, the limit on plant and machinery in the small scale industrial sector has been enhanced from the earlier level of Rs. 60 lakh (Rs. 75 lakh in the export-oriented and ancillary units) to Rs. 3 crore and for the tiny sector from Rs. 5 lakh to Rs.25 lakh. In this context, it has been decided that out of the funds available to all the segments of the small scale industrial sector, smaller units get adequate share. The banks have, therefore, to ensure that 40% of the bank credit is made available for the units with investment in plant and machinery upto Rs. 5 lakh, 20% for units with investment between Rs. 5 Lakh and 25 lakh and the remaining 40% to other SSI units. 49

During the year 1995-96, Public Sector Banks operationalised 169 specialised SSI branches and were asked to operationalise 100 more specialised branches during the year 1996-97. As at the end of March 1997, cumulatively, 353 specialised SSI branches have been operationalised. This step will increase the flow of credit to SSI based on viability consideration.

Provision of adequate and timely credit for SSI is crucial. The public sector banks advances increased from Rs.257 crore in June 1969 to Rs.21,561 crore in 1994, Rs. 25,843 crore in March 1995, Rs. 29,482 crore in March 1996 and further to Rs. 31,542 crore at end March 1997 as would be observed from the following table 50:

SOURCES:

48. Expert Group on Small Scale Enterprises, Chairman Abid Hussain, Report submitted in January 1997

49. Report on Trend and Progress of Banking in India, 1996-97 (July-June) RBI, Page 33

50. Report on Trend and Progress of Banking in India, 1996-97 (July-June) RBI, Page 33

Advances to Small Scale Industries by Public Sector Banks

Year	Amount outstanding (Rs. crore)	% to net bank credit
June 1969	257	8.5
March 1994	21,561	15.3
March 1995	25,843	15.3
March 1996	29,482	16.0
March 1997	31,542	16.6

In addition to substantial increase to small scale industries public sector banks in terms of credit outstanding, their share in net bank credit also increased from 8.5% in June 1969 to 16.6% in March 1997.

Credit facilities extended to small scale industries by old private banks also increased from Rs. 2,150 crore in March 1995 to Rs. 2,574 crore in March 1996 and further to Rs. 3,009 crore in March 1997 as would be observed from the following table :

Advances to Small Scale Industries by Old Private Banks 51

Year	Amount outstanding (Rs. crore)	% to net bank credit
March 1995	2,150	15.8
March 1996	2,574	18.3
March 1997	3,009	21.1

In terms of the share of SSI in net bank credit, the percentage has increased from 15.8% in March 1995 to 21.1% in March 1997, which is even higher as compared to 16.6% by public sector banks in March 1997.

Advances to small scale industries by new Indian private sector banks is given in the following table:

SOURCES:

51. Report on Trend and Progress of Banking in India, 1996-97 (July-June) RBI, Page 33

Advances to Small Scale Industries by New Indian Private Banks [52]

Year	Amount outstanding (Rs. crore)	% to net bank credit
March 1996	908	20.7
March 1997	1,708	24.9

The advances to SSI sector by new private banks has improved from 20.7% of their net bank credit in March 1996 to 24.9% in March 1997, which is better than that of public sector banks at 16.6% and old private sector banks at 21.1% in March 1997. It shows their commitment to achieve the priority sector target.

The advances to small scale industries by foreign banks in India is given in the following table:

Advances to Small Scale Industries by Foreign Banks in India [53]

Year	Amount outstanding (Rs. crore)	% to net bank credit
March 1996	1,519	11.0
March 1997	1,826	11.1

Foreign banks, who are considered to be basically governed by profit motive, have also extended credit to SSI to the tune of Rs. 1,519 crore in March 1996 representing 11% of their net bank credit, which increased to Rs. 1,826 crore in March 1997, accounting for 11.1% of their net bank credit.

The Ninth Five Year Plan Approach Paper has laid renewed emphasis on augmentation of credit flow to SSI by motivating financial institutions to offer factoring services in addition to the present system of discounting of bills. Special attention is to be paid to technology upgradation for traditional industries like handlooms, powerlooms, coir, wool, handicrafts etc.

SOURCES:

52 & 53. Same as item No. 50 & 51 on the previous page

Sick Small scale Industrial Units

We give below the trends in bank credit to Sick SSI units with comparative position of bank credit to sick medium and large industrial units in India:

Trends in Bank Credit to Sick SSI Units in India : 1980-94 54 (Rs. Crore)

Year End -June	Small Scale Units Amount Outstanding		Percentages to Bank Credit		
	Bank Credit to Sick SSI Units	Total Bank Credit to SSIs	Bank Credit to Sick SSI Units	Bank Credit to Sick Medium & Large Ind.	Bank Credit to total Sick Industries
1980	295	3,068	9.6	5.6	6.1
1985	955	6,629	14.4	6.1	7.2
1988	1,980	9,493	20.9	4.9	7.0
1992 March	3,101	18,150	17.1	12.3	13.6
1993 March	3,443	20,026	17.2	13.5	14.4
1994 March	3,680	22,617	16.3	14.1	14.7

Thus bank credit to sick SSI units has increased from Rs.295 crore (accounting for 9.6% of total bank credit) in 1980 to Rs. 1,980 crore (accounting for 20.9% of total bank credit) in 1988. Although it further increased to Rs.3,680 crore in 1994 but its proportion to total bank credit decreased to 16.3% in March 1994. As compared to the ratio of bank credit to the medium and large industries to total credit to sick industries, the proportion is higher in case of sick SSI units but it is coming down. Various factors for sickness of SSI units are deficiencies in project management, non-availability of raw materials, power shortage, transport bottlenecks, financial problems, fall in demand of the product and wilful default on the part of the borrower. Need-based and timely sanction of loans after examining techno-economic feasibility of the proposal, pre-sanction and post-sanction surveys, periodical inspections and monitoring of accounts are some of the methods for proper control over advances to SSI and timely diagnosis of sickness for initiating suitable remedial measures. Rehabilitation , compromise or legal remedy are the other recourses available to the bankers.

Banks must endeavour for early detection of sickness or better to call it incipient sickness by setting up Departments and devising monitoring devices which should be properly analysed and interpreted and should not remain mere statistical returns. The RBI has constituted a Standing Coordination Committee to consider issues relating to co-ordination among the banks, financial institutions, Central/State Governments.

SOURCES:

54. Report on Currency and Finance, Volume I, Various issues, Reserve Bank Of India

2.5.4 *CREDIT DELIVERY SYSTEM IN INDIA*

The distribution of bank credit in terms of type of accounts is another significant factor to examine the proportion of working capital to term loan accounts and also the advances to export sector. The table showing distribution of outstanding credit of scheduled commercial banks by type of accounts is given below:

Distribution of Outstanding Bank Credit of Scheduled Commercial Banks by Type of Account 55 (Rs. Crore)

Category	Bal. Dec. 1972	% to total	Bal. Dec. 1980	% to total	Bal. March 1990	% to total	Bal. March 1994	% to total
1. Cash Credit	2,544	50.4	8,578	42.4	29,054	36.2	57,319	39.9
2. Overdrafts	480	9.5	1,345	6.7	5,879	7.3	11,114	7.7
3. Demand Loans	331	6.6	981	4.9	2,913	3.6	9,219	6.4
4. Term Loans	601	11.9	4,492	22.2	24,643	30.7	40,887	28.5
5. Packing Credit	210	4.1	755	3.7	3,973	5.0	7,592	5.3
6. Bills purchased and Discounted of which	874	17.3	4,070	20.1	12,624	15.8	16,790	11.7
(i) Export Bills	212	4.2	796	3.9	3,025	3.8	7,155	5.0
(ii) Import Bills	632	12.5	3,057	15.1	8,280	10.3	8,780	6.1
(iii) Advances against Import Bills	30	0.6	217	1.1	1,319	1.7	855	0.6
7. Others	11	0.2	--	--	1,079	1.4	782	0.5
Total Bank Credit	5,051	100	20,221	100	80,165	100	1,43,703	100

SOURCES:

55. Banking Statistics , Various issues, Reserve Bank Of India

Cash credit and overdrafts are running accounts and are beneficial to the borrowers as they have to pay interest on actual daily balances and the amount deposited by them on any day of the month gives them the advantage of interest application on the reduced balance. In fact cash credit system was a legacy of the Scottish bankers. But these accounts pose a problem for banks in the matching exercise of assets and liabilities. The trend of reducing percentage of Cash Credit Accounts is a result of banks' sustained efforts for loan component repayable in instalments in case of large advances to enforce better credit discipline. On the other hand, higher proportion of term loans, which are payable in instalments indicates bank's active assistance to the borrowers for purchase of fixed assets/equipment/machinery. The proportion of bank credit for export bills and packing credit have also increased showing banks' commitment to extend credit facilities for export sector, which is vital for Indian economy.

In order to prevent concentration of scarce credit resources for a few large borrowers, Reserve Bank Of India introduced in 1965 Credit Authorisation Scheme (CAS) making compulsory prior authorisation of Reserve Bank Of India by banks before making credit limit of Rs. one crore or more available to a borrower. This limit was subsequently raised to Rs.4 crore. The inflationary years of 1973 and 1974 prompted a closer look at CAS. Tandon Committee 56, which was set up by RBI in 1974 submitted its recommendations containing guidelines for assessing credit requirements of industry and in addition proposed specific norms for inventories and receivables for 15 industries for credit limits of Rs. 1 million or more. They also prescribed a minimum current ratio. The concept of 'Maximum Permissible Bank Finance' (MPBF) emerged from the recommendations of Tandon Committee. Chore Committee 57 made the provisions more stringent for credit limits of Rs. 5 million or more. Borrowers were additionally required to ensure that their current assets were financed at least to the extent of 25% through long term funds. As a result of implementation of recommendations of the above Committees, the inventory and receivables management of the corporate sector considerably improved. Consistent with the policy of liberalisation in the context of banking sector reforms, the instructions relating to 'Maximum Permissible Bank Finance' (MPBF) were withdrawn by Reserve Bank Of India with effect from 15th April 1997 but banks were given the freedom to retain the system.

The Public Sectors Banks were advised by Reserve Bank Of India that in the case of borrowers enjoying working capital limit of Rs.20 crore and above, the 'Cash Credit' component would be 20% and the balance 80% would be in the form of 'Loan Component'. In the case of borrowers enjoying working capital limit of Rs.10 crore but less than Rs.20 crore, loan component would be 75% and CC component 25% . The 'cash credit' component is a floating limit, whereas 'Loan Component' is repayable in instalments. This system imparts greater discipline on the part of the borrowers and reduces their dependence on bank credit over a period of time. Besides, it helps in a much better Asset-Liability Management for banks as repayment schedules are fixed in respect of term loan component at the time of sanction of loan.

SOURCES:

56. "Report of the Study Group to Frame Guidelines for Follow-up of Bank Credit. 1975, Chairman Sri Prakash Tandon, RBI (1975)

57. " Report of the Working Group to Review the System of Cash Credit, Chairman Sri K.B.Chore, RBI (1979)

2.6 PROFITABILITY OF BANKS IN INDIA IN PRE-REFORMS PHASE

" The bank's objective ", says Cargill, " is to make profit. No matter how public spirited or the advertising campaign of the bank, no matter how many public activities the bank supports, the basic objective of the bank is to make profits." 58 Profitability is the yardstick of a healthy organization. Despite the achievements of the banks by increasing their geographical and functional coverage in the post-nationalization period, their operational efficiency was low characterised by low profitability, high and growing non-performing assets and relatively low capital base. The problem of low profitability had already started during 1975-80 as would be observed from the following table:

Growth of Banking Operations
(Commercial Banks) 59
Compound Annual Growth Rate Percent

Period	Total Business	Working Funds	Total Earnings	Total Expenses	Balance of Profit
Ten Year Period (1970-80)	19.5	20.1	24.7	24.9	22.8
Five Year Period (1970-75)	18.1	18.8	27.7	27.2	26.7
Five Year Period (1975-80	20.5	21.6	16.3	22.1	13.7

Note: (1) Total Business : Average deposits + Average credit (2) Working funds :Average deposits + Average Borrowings (3) Balance of profit is operating profit

The rate of increase of total earnings and total expenses was highest during 1970-75, even higher than total business and working funds. It also reflected on growth of profits of commercial banks which increased at the fastest rate of 26.7%. The rate of increase of both total earnings and total expenses declined during 1975-80 but rate of decline in total earnings was much faster than total expenses. Consequently, there was a sharp fall in the rate of growth of profits of commercial banks. Compounded annual growth rate of operating profit decreased from 26.7% during 1970-75 to 13.7% during 1975-80. The slower growth of earnings

SOURCES:

58. Ibid., pp. 83-98

59. Statistical Tables relating to Banks in India, various issues, Reserve Bank Of India

as compared to total business and working funds could partly be attributed to rising proportion of low *yielding assets such as investment in Government securities, food credit and priority sector advances during* 1975-80. The rising proportion of high cost deposits and also increase in the operating cost contributed to faster growth of expenses as compared to that of earnings. The interest expenses, which accounted for 55% of total expenses increased to 66.2% of total expenses in 1980.

The declining trend in bank profitability of commercial banks in India caused concern. But there were different reactions to this phenomenon. While some economists termed it as ' new inescapable development responsibilities' 60 , other felt that such activities were essential in view of shrinking business opportunities in the traditional fields. 61 Not withstanding the opportunities provided for exploring business prospects in unbanked areas, the decline in profits marked the beginning of the future problems relating to viability and efficiency of banking sector. It led to setting up of Luther Committee. 62 The Committee applied criteria of productivity, social objectives (both spatial and sectoral) and profitability. In its opinion, assessment of operational efficiency at a more disaggregated and homogenous level of groups was necessary since it appeared to be more realistic than to evolve an efficiency measure at overall level.

In the pre-reform period i.e. prior to 1991, the spread between interest earned and paid as a proportion of working funds was 2.95% in 1990-91. The gross operating profit as a proportion of total assets of scheduled commercial banks in India was only 0.8% in 1970s, 0.91% in 1980s and 1.5% in early 1990s. Similarly, net profit of scheduled commercial banks declined from 0.12% in the 70s to 0.11% in the 1980s and turned negative to (-) 0.07% in the early 1990s. 63 The capital base- the ratio of paid up capital and reserves to deposits of public sector banks at slightly over 2.85% in 1990-91 was much lower by international standards and had gone down over time...... The position of Regional Rural Banks was far worse. The balance sheet of the performance of the banking sector was thus, mixed- strong in widening the credit coverage but weak as far as viability and sustainability was concerned. (Dr. Rangarajan) 64

Banking industry is a multi-product service industry. Several endogenous and exogenous factors

SOURCES:

60. " Developmental Responsibility and Profitability of Banks", Kulkarni L.G., Economic and Political Weekly , Vol. 14, No. 34, August 1979

61. " Banking Differently ", Chawla A., Kilam L, Mehta J., Siddartha Publications, New Delhi, 1994 Edition

62. Report of the Productivity, Efficiency and Profitability Committee on Banking , Chairman Luther J.C., 1977, Reserve Bank Of India , Bombay

63. " Banks in Financial Intermediation", Ajit D. & Bangar R.D. Reserve Bank Of India, Occasional Papers, Vol. 18 Nos. 2 & 3, June and September 1997, Page 325

64. Ibid., pp. 83-98

accounted for the poor profitability and lower efficiency parameters of the banks. It was a cause of great concern and it led to much needed banking sector reforms in India. In view of the crucial importance of financial sector reforms of which banking sector is a part, next chapter has been devoted for this purpose and profitability of commercial banks in the post-reforms phase has been analysed in another chapter.

2.7 CONCLUSION :

Thus commercial banks in India have undergone metamorphic change during the last four decades. Nationalisation of 20 commercial banks (now 19 after merger of one bank) was a turning point in the history of banking sector. The major objective of nationalisation was spread of Banks through out the length and breadth of the country and banks covered hitherto unbanked and underdeveloped areas. This helped the banks to tap resources even from the rural and semi-urban areas and bring them to the main stream of the productive process. This met the emerging needs of a developing country like India because a large percentage of Indian population lives in villages. The number of branches of commercial banks increased from 8,262 in June 1969 to 63,513 in June 1997 and population served per branch has decreased from 64,000 in 1969 to 1,5000 in 1997; giving an opportunity to serve people better. Percentage of scheduled commercial bank branches in rural branches has improved from 22.2% in June 1969 to 51.9% in June 1997. Opening of branches in rural, undeveloped and underdeveloped areas has led to evening out of regional disparities in banking.

Bank deposits as percentage of GDP at current prices increased from 13.7% in June 1969 to 43.2% in June 1996. Savings of the household sector in banks increased from 14.7% (1951-52 to 1955-56) to 38.2% in 1996-97. Savings in the form of currency holding decreased from 14.9% to 8.9% during the corresponding period, which shows that idle saving of household was channelised into banks. Thus bank branches, which serve as delivery centre of services, have increased coupled with significant growth in savings, which reflects institutionalization effect on savings.

On one hand, savings have been tapped and, on the other hand, financial requirements of neglected sectors have been met by the banks. Several Government Sponsored Schemes of loans to weaker sections and Poverty Alleviation Schemes were launched in rural and underdeveloped areas. Share of priority sector advances increased from 14.6% of total bank credit of public sector banks in June 1969 to 41.7% of net bank credit in March 1997. Share of small scale industries in advances of public sector banks increased from 10.9% of gross bank credit in June 1969 to 13.7% of gross bank credit and 16.6% of net bank credit in March 1997. Share of agricultural credit extended by public sector banks increased from 5.4% to 16.4% during the aforesaid period. Thus nationalisation of banks has led to phenomenal growth of banking sector in branch expansion, deposit mobilisation, increase in bank credit and direction of credit to priority sector.

Reserve Bank Of India has also played a crucial role in the development of banking sector in India. It has taken alround initiative like introduction of Lead Bank Scheme, creation of Deposit Insurance & Credit

Guarantee Corporation Of India, National Bank for Agriculture and Rural Development and Unit Trust Of India.

These developments have brought in its wake several problems. Growth can not be an end in itself. Unless the organisation is economically viable, growth can not self-sustaining. Administered system in the form of directed investments like SLR and CRR, directed lendings in the forms of priority sector lendings, regulation and cross subsidisation of interest rates had depressed income of banks , on one hand and on the other hand intervened with the market mechanism creating problems visible in ' repressed economies.' Banks were not adhering to international standards in regard to assets classification. The objective yardstick for identifying 'performing' and ' non-performing ' was required. Capital base is very crucial to verify the strength of an organisation but banks in the pre-reforms period had low equity base.

The process of changing the character and structure of banks is a global phenomenon. The issues like banking sector liberalisation and reform including prudential control and interest rate policies have engaged worldwide attention. In India too need was felt for setting up a high powered committee to submit comprehensive recommendations on the structure, organisational systems and procedures and supervisory arrangements etc. of the financial system, in general, and banking sector in particular, so as to improve its efficiency, effectiveness and profitability. The system was also required to be modernised, competitive and more transparent. These factors led to setting up of Narasimham Committee. The recommendations of the Committee and action taken have been analysed in the next Chapter.

Chapter III

Banking Sector Reforms in India

3.1 Introduction

3.2 Recommendations of Narasimham Committee on Financial Sector Reforms with action taken

(i) Reduction in Directed Investment i.e. SLR and CRR

(ii) Directed credit in the form of priority sector lendings

(iii) Deregulation of interest rates

(iv) Prudential Norms

(a) Capital Adequacy Ratio

(b) Investment Portfolios of commercial banks

(c) Income Recognition, Assets Classification (IRAC) Norms and non-performing assets (NPAs)

(v) Establishment of Debt Recovery Tribunals

(vi) Setting up of Assets Reconstruction Fund (ARF)

(vii) Structural reorganisation of the banking system

(viii) Entry of private and foreign banks

(ix) Branch Licensing Policy

(x) Organisation, methods and procedures in banks

(xi) Mechanisation and computerisation

3.3 Second Narasimham Committee on Banking Sector Reforms

(i) Capital Adequacy

(ii) Asset quality and non-performing assets

(iii) Directed credit

(iv) Prudential norms and disclosure requirements

(v) Systems and methods in banks

(vi) Size of workforce

(vii) Information technology in banks

(viii) Weak banks

(ix) New banks

3.4 Conclusion

Chapter III

BANKING SECTOR REFORMS IN INDIA

3.1 INTRODUCTION :

The post-nationalisation period in the banking industry witnessed geographical and functional spread of banking but productivity and efficiency of the system suffered. There was pre-emption of resources of banks in the shape of high statutory liquidity ratio and cash reserve requirements. The portfolio quality of banks had deteriorated; adversely affecting cycling of funds and generation of income resulting in a decline in their profitability. The erosion of profitability adversely affected their competitive strength. In the pre-reform period i.e. prior to 1991, the spread between interest earned and paid as a proportion of working funds was 2.95% in 1990-91. The average gross operating profit as a proportion of total assets of scheduled commercial banks in India was only 0.8% in 1970s, 0.91% in 1980s and 1.5% in early 1990s. Average net profit of scheduled commercial banks was 0.12% in the 1970s, 0.11% in the 1980s and a negative of (-) 0.07% in the early 1990s. 1 The capital base- the ratio of paid up capital and reserves to deposits of public sector banks at slightly over 2.85% in 1990-91 was much lower by international standards and had gone down over time. The decline in profitability had emanated from the factors operating both on the side of income and expenditure. Both exogenous and endogenous factors were causing the problem.

In tune with proposed structural reforms in the real sector of the economy, Government decided to bring about reforms in the financial sector. A High Level Committee was, therefore, set up in August 1991 under the Chairmanship of M.Narasimham 2 to examine all aspects relating to the structure, organisation, functions and procedures of the financial system. The aforesaid Committee on the Financial System submitted its Report in November 1991 and it laid the foundation of financial sector reforms in India; banking sector reforms constituted a part thereof. The approach of the Committee to the issue of financial sector reforms was to ensure that the financial service industry operates on the basis of operational flexibility and functional autonomy with a view to enhancing efficiency, productivity and profitability highlighting the need of a vibrant and competitive financial system necessary to sustain the ongoing reform in the structural aspects of the real economy.

3.2 RECOMMENDATIONS OF NARASIMHAM COMMITTEE ON FINANCIAL SECTOR REFORMS

The important recommendations of Narasimham Committee alongwith their rationale have been

SOURCES:

1. " BANKS IN FINANCIAL INTERMEDIATION : PERFORMANCE AND ISSUES ", Ajit D. and Bangar R.D. , Reserve Bank Of India Occasional Papers, Volume 18 Nos. 2 &3 , June and September 1997

2. Report dated November 8, 1991 of the Committee on the Financial System with M. Narasimham as its Chairman , Reserve Bank Of India

analysed below alongwith action taken thereon by Reserve Bank Of India and their impact on the banking system in India :

(i) Reduction in Directed Investment i.e. Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR)

Recommendation:

The Committee observed that one of the major elements constricting the operational flexibility of banks and depressing their earnings had been the system of directed investment in terms of the minimum *statutory liquidity ratios. This alongwith the variable cash reserve ratios accounted for pre-emption of* substantial resources of the banking system. SLR of 38.5% of net demand and time liabilities plus variable cash reserve ratio of 15% and 10% incremental ratio made a total of 63.5% in the pre-reform period. SLR had increasingly been used to finance public sector investment and the rate on Government securities was less than the market rate and in effect, it was acting as a tax on the banking system. The Committee was of the view that these should be related to prudential requirements and as **such SLR should be brought down to 25% of net demand and time liabilities over the next 5 years.** A reduction in SLR was expected to enable the banks to allocate their resources on a flexible and efficient basis to promote investment and production with due regard to productive use of their resources. The Committee also suggested that **that the Government borrowing rates should progressively be market related and help to augment banks' income.**

As regards CRR, the Committee felt that this instrument can be operated in terms of monetary policy goals and a **progressive reduction in the CRR from its present high level be considered. In any event if the instrument of CRR were deployed, the Reserve Bank should pay interest on impounded deposits.**

Action Taken

Easing of external constraints like SLR and CRR constituted a major part of the reforms agenda. As a measure of banking sector reform, other countries also had eased such type of restraints. 3 In India SLR was brought down in phases to 25% effective from October 22, 1997. With the introduction of auction system of Central Government securities, the rate of interest on Government securities has become near market-related.

SOURCES:

3. "Changes over the past 2 decades in the Bank Of England Group (consisting of 44 developing countries from Africa , Asia , Middle East , Europe and Western Hemisphere including India) suggest that financial repression is on the wane as source of Government revenue, perhaps in part as a result of the accumulated evidence of the deleterious effect on economic growth ."
" CENTRAL BANKING IN DEVELOPING COUNTRIES : OBJECTIVES, ACTIVITIES AND INDEPENDENCE ", Fry Maxwell J. , Goodheart Charles A.E. And Almedia Alvaro, Routledge, London

CRR was also reduced in phases and major reduction was brought about from 14% on 9th December 1995 to 10% w.e.f. 18th January 1997. The aforesaid cuts in CRR freed cash balances and augmented lendable resources of the scheduled commercial banks by about Rs. 17,850 crore during the fiscal year 1996-97. Therefore, reserves of banks as a proportion of bank deposits (cash in hand and balances with Reserve Bank Of India) declined from 12.4% to 10.6% on March 29, 1996 and further to 10.5% on March 28, 1997. CRR was further reduced to 9.5% with effect from November 22, 1997. CRR was changed upwards as well as downwards on a number of occasions between December 1997 and August 1998. With effect from August 29, 1998, CRR was again raised to 11% with a view to halting the fall in the external value of the Rupee.

As a part of rationalisation measure, effective October 25, 1997. interest paid by the Reserve Bank Of India on eligible cash balances maintained under CRR of banks was raised to 4% from the effective rate of interest of 3.5% under the two-tier formula. 4

Release of the above resources was coupled with an increase of 22.8% and 12.1 % in deposits in 1994-95 1995-96 respectively and expansion of bank credit by 28.7% and 20.1% in 1994-95 and 1995-96 respectively. This trend reflected an encouraging trend of utilisation of additional resources for productive purposes. But in 1996-97 deposits of scheduled commercial banks increased by 16.5% but bank credit remained sluggish and increased only by 9.6% during 1996-97. Food credit declined by 22.4% in 1996-97 as compared to a decline of 20.3% in the previous year. Non-food credit expanded by 10.9% in 1996-97 as compared to the expansion of 22.5% in 1995-96. Credit-Deposit Ratio of scheduled commercial banks, therefore declined from 58.6 as on March 29, 1996 to 55.1% as on March 28, 1997. Consequently, investment of scheduled commercial banks in Government and approved securities increased by 15.6% in 1996-97 as compared with the rise of 10.4% in 1995-96. The investment-deposit ratio of scheduled commercial banks was 38% on March 29, 1996 and 37.7% on March 28,1997 as against SLR prescription of 25%. A major factor underlying the sluggish credit growth was the deceleration in industrial growth. Industrial production recorded a lower growth of 6.6% in 1996-97 than that of 11.8% in 1995-96. Secondly, the increase in the risk-adjusted yields on the Government securities has had the effect of making investments in risk-free Government securities more attractive.

The yield on Government securities had a mixed trend in post-reforms period. The average implicit yield at cut off prices on 91-day treasury bills increased from 9.16% in 1994-95 to 12.67 in 1995-96 but came down to 9.67% in 1996-97 due to containment of inflation. Similarly, yield on 364-day treasury bills increased from 10.15% in 1994-95 to 12.87% in 1995-96 but declined to 11.67% in 1996-97. The 10-year dated security after gaining from 12.35% in 1994-95 to 14% in 1995-96 declined to 13.65% in 1996-97. 5 In view of low credit offtake, banks tended to look for opportunities for investment for maintaining profitability. Consequent upon the softening of interest rates on Government securities in 1996-97 as compared to 1995-96, the depreciation provided on investments held by banks as at the end of 1995-96 turned out to be in excess of

SOURCES:

4. Reserve Bank Of India Bulletin December 1997
5. Report on Trend and Progress of Banking in India, 1996-97 (July-June), Reserve Bank Of India

the requirement for the same for 1996-97. In view of the fact that banks have yet to mark their entire portfolio of investments to market, RBI directed the banks to take such excess provisions to profit and loss account as a credit item and transfer the same to Capital Reserve Account. Due to a general downtrend in the rate of interest in the economy, interest on Government securities has started falling during 1997-98 and Government has also taken several steps to encourage industrial growth and expansion of bank credit will pick up.

(ii) Directed Credit in the form of Priority Sector Lendings

Recommendation

The Committee observed that another factor that has tended to depress bank's potential income has been the system of directed credit programmes. The targeted proportion of priority sector lending is 40% of total bank credit. But fulfillment of quantitative target has been at a cost of deterioration of the quality of loan portfolio, the growth of overdues and consequent erosion of profitability. The other factor relating to priority sector lendings that has affected banks' profitability has been the stipulation of concessional lending rates. The Committee felt that the pursuit of redistributive objective should use the instrumentality of fiscal rather than the credit system. Therefore, directed credit programmes be viewed not as a regular feature but rather as a case of extraordinary support to certain sectors in the absence of economic compulsions to make credit available to them and designed to correct perceived imperfections in the credit market. Such intervention should be seen as a temporary rather than a permanent feature. Moreover, the growth of agriculture and small industries in India has reached a point where the legitimate productive requirements of these sectors (or large part of them) could be met by the banks on the basis of their commercial judgment. The Committee, therefore, suggested that **the system of directed credit programmes should be gradually phased out.** The process of phasing out would recognise the need that for some time it would be necessary to provide some directed special credit support to some sectors. The Committee, therefore, proposed that directed credit programmes should cover a redefined priority sector, consisting of small and marginal farmer, tiny sector of industry, small business and transport operators, village and cottage industries, rural artisans and other weaker sections. The Committee proposed that **the credit target for this redefined priority sector should henceforth be fixed at 10 percent of aggregate bank credit.** Credit for agriculture and small industry should be on the basis of a proper techno-economic appraisal. The Committee also felt that easy and timely access to credit is far more important than its cost and hence it recommended that concessionary rates of interest for priority sector loans of small sizes should be phased out.

Action taken

This recommendation for reduction in the priority sector lending from 40% to 10% was not accepted as it was felt that given the imperfections of the credit market, credit allocations for certain sectors have become necessary in the Indian context. With the enlargement of the coverage of priority sector advances and revised definition of SSI (raising investment limit of plant and machinery to Rs. 3 crore) and banks being more careful of the recovery of their dues, it is hoped that directed credit will hold better prospects in future.

Minimum lending rate (MLR) for credit limits of over 2 lakh was abolished from October 18, 1994 and banks were free to fix their prime lending rates (PLR) which would be the minimum lending rate charged by banks for credit limits of over Rs. 2 lakh. 6 With a view to protecting small borrowers, only prescription of two concessional rates for priority sector i.e. upto Rs. 25,000 and Over Rs. 25,000 and upto Rs. 2 lakh has been retained. Priority sector borrowers beyond Rs. 2 lakh will be governed by general interest rate prescriptions of banks. This will ensure flow of credit to the designated sectors but without compromising with the viability and profitability of banks. The banks have to ensure that loan proposals of priority sector applicants are properly appraised. Banks have complete discretion to reject a non-viable proposal. Banks are alive to their socio- economic responsibilities and total advances of public sector banks to priority sector increased from Rs. 69,609 crore in 1995-96 (37.8% of net bank credit) to Rs.79,131 crore in 1996-97 (41.7% of net bank credit). By opening more specialised branches for financing agriculture and small scale industries, banks are paying more attention on proper credit appraisal of advances and credit management.

(iii) Deregulation of Interest Rates :

Recommendation

As regards administered interest rates, the Committee observed that administrative structure of interest rates was characterised by great complexity and inverted yield pattern. The complexity arose from differential interest rates and inverted yield was, inter alia, largely a consequence of inflation. The Committee felt that interest rates should be increasingly allowed to perform their main function of allocating scarce loanable funds among alternative uses and for achieving this purpose **the medium term objective should be to move towards market determined interest rates.** The Committee, however, advocated a cautious approach to deregulation. In the absence of macro-economic balance and control of inflation; total deregulation could pose the danger of excessive bank lending at high normal rates to borrowers of dubious credit-worthiness eventually creating acute problems for the banks as well as the borrowers.

Action taken

If we trace the background of regulation of interest rates in India, we observe that from October 1, 1958 commenced the system of fixing of interest rates on the basis of Inter-Bank Agreement. From 1964. intervention of Reserve Bank Of India increased in the money and credit markets. RBI prescribed certain minimum and ceiling rates on deposits and a ceiling rate on advances. After nationalisation of banks, the

SOURCES:

6. Reserve Bank Of India , Bulletin December 1997

administered interest rate system became more complex. The purpose behind this structure was largely to direct implicit subsidy to certain sectors and to enable them to obtain funds at concessional rates of interest. An element of cross-subsidization crept into the system where concessional rates of directed credit have to be compensated by higher rates of interest from other sectors. This led to administration of deposit rates too so that reasonable interest spread is available to the banks. This resulted in, besides complexities, to market fragmentation and inefficient allocation of resources, which is characteristic of a 'repressed economy'. In this context, mention may be made of the observations of Ronald Mckinnon and Edward shaw, which they made while making financial sector analysis of developing countries which are financially repressed. They observed that indiscriminate distortion of financial prices including interest rates reduce the real rate of growth of the economy. 7 Bascom also pleaded for deregulation of interest rates for efficient allocation of credit. 8

Realising the problems arising out of the administered interest rate, a process of simplification commenced in September 1990, when number of slabs for lendings were reduced. After initiation of reforms, Reserve Bank Of India adopted a gradual approach for reforming the interest rate structure in India so that banks and financial intermediaries do not have such incentives, which tempt them to lend at high rates of interest assuming higher risks and thus becoming victims of 'adverse selection.' 9

Effective April 22, 1992, domestic deposit rates were subject to only one ceiling rate as against the earlier several prescribed rates. Commencing from 1st October 1995, banks were allowed to fix their own interest rates on domestic term deposits with a maturity of over two years subsequently reduced to over 1 year w.e.f. 2nd July 1996. Finally in order to give full freedom to banks to determine the interest rates on term deposits, effective October 22, 1997, banks were allowed to fix their own interest rates on term deposits of 30 days and over. As regards lending rates, the structure of interest rates prescribed only 4 categories w.e.f. April 22, 1992. Subsequently, rates prescribed w.e.f. April 8, 1993, effective from October 18, 1994, Maximum Lending Rate (MLR) for over Rs.2 lac was abolished and banks were free to fix their own Prime Lending Rates (PLRs), which would be the minimum rate charged by banks for credit limits of over Rs. 2 lac uniformly at all branches. Administered lending rates for two slabs for credit limits upto Rs. 25,000 and for credit limits of over Rs. 25,000 and upto Rs. 2 lakh for all advances (including term loans) was retained, as also discussed in the previous paragraph.

SOURCES:

7. " FINANCIAL DEEPENING IN ECONOMIC DEVELOPMENT ", OUP 1973, E.S.Shaw & " MONEY AND CAPITAL IN ECONOMIC DEVELOPMENT ", OUP 1973 , R.W.Mckinnon

8. In his book " The Economics of Financial Reform in Developing Countries ", Wilbert O. Bascom , Chief of Bureau of International Banking , State of Florida, has observed that " An objective of financial reform is to liberalise financial markets by deregulating interest rates and by permitting financial institutions to allocate credit on the basis of viability and productivity of borrowers , their enterprises or projects."

9. Excerpts from the Speech in Y.B. Chavan Memorial Lecture by Dr. C. Rangarajan , the then Governor, Reserve Bank Of India on December 30, 1994 at Bombay

(iv) Prudential Norms:

Another major element of financial sector reform relates to prudential norms and regulations, directed to ensure safety and soundness of the financial system, impart greater transparency and accountability in operations of the Indian financial system. Prudential reforms relate to income recognition and assets classification (IRAC), provisioning for bad and doubtful debts and capital adequacy requirements. IRAC norms serve two basic purposes. First, they bring about true position of bank's balance sheet and second, they help to arrest its deterioration.

(a) Capital Adequacy Ratio

Recommendation

The ratio of capital funds in relation to bank's deposits or assets is a well recognised and universally accepted measure of strength and stability to the institution. The Basle Committee on Banking Regulations and Supervisory Practices appointed by the Bank of International Settlements (BIS) prescribed Capital Adequacy Ratio (CAR) of 8% of the Risk-Weighted Assets. For the purpose of calculating capital adequacy, risk weightages have to be assigned to different category of assets. For the purpose of calculation of capital, BIS has classified capital into two broad categories, namely Tier I capital consisting of share capital and disclosed reserves and Tier II capital consisting of undisclosed and latent reserves, general provisions etc. The Committee recommended **that all banks in India should reach the figure of 8% of risk-weighted assets in a phased manner.** Banks having an international scale of operations should reach this norm as early possible and in any event within 3 years i.e. by March 1994. As far as other banks are concerned, they should achieve a capital adequacy norm of 4% by March 1993 (of which tier I capital should not be less than 2%) and 8% norm in full within the next 3 years. i.e. by March 31, 1996. Before, however, the norms of capital adequacy are complied with by Indian banks, it is necessary to have their assets revalued on a more realistic basis and on the basis of their realisable value. After making these adjustments it would be necessary to inject further capital to achieve the capital adequacy norms. For the banks which have had a consistent record of profitability and enjoy a good reputation in the market, it should be possible to tap the capital market by issuing fresh capital to the public.

Action taken

In order to improve the financial health of the banking system, the recommendations of Narasimham Committee for adoption of the BIS (Bank Of International Settlements) norms on capital adequacy were accepted and Reserve Bank Of India introduced a risk based capital standard for banks in 1992-93. These are part of prudential regulations. Indian banks, which have branches abroad, were required to achieve the norm of 8% by 31st March 1995 Other banks were required to achieve this norm by March 31, 1996.

Net losses incurred by nationalised banks in the initial post-reforms phase had an adverse impact on their capital. Net losses for nationalised banks amounted to Rs. 3,648 crore (1.72% of their total assets) in 1992-93 and Rs. 4,705 crore (1.94% of their total assets) in 1993-94 and Rs. 1,164.51 crore (0.36% of their total assets) . These losses considerably depleted the capital base of loss incurring banks. These banks had two routes available for induction of capital. First route was accessing the capital market. State Bank Of India was the first public sector bank and Oriental Bank Of Commerce, the first nationalised bank to access the capital market. Some other nationalised banks like Bank Of India, Bank Of Baroda and Dena Bank also accessed the capital market. The Government Of India made a provision Rs. 5,700 crore in the Union Budget 1993-94 for recapitalisation of nationalised banks. For further strengthening the capital base of nationalised banks, a sum of Rs. 5,600 crore was provided in the Union Budget 1994-95. The Government Of India made further budget provision of Rs. 909 crore for recapitalisation of some more nationalised banks in the Union Budget of 1996-97. 10 The budget allocation for capitalisation of banks is made available in the form of investment in 10-year Government Of India Bonds known as ' 10% Recapitalisation Bonds 2006'. Thus there is no cash inflow. On the liabilities side equity (Tier I capital) is boosted by creating an equivalent investment on the assets side. The bonds are non-SLR securities and are non-transferable.

With the measures of recapitalisation by the Government Of India and accessing the capital market by some banks, the Capital Adequacy Ratio of 8% was achieved by 25 Public Sector Banks in March 1997 as against 19 PSBs in March 1996. Out of 25 old Private Sector Banks, 21 banks had achieved CAR of 8% in March 1997 as against 19 banks in March 1996. All nine New Private Sector Banks and 39 Foreign Banks had CAR of 8% or more. Thus Capital Adequacy position of commercial banks has considerably improved.

(b) Investment Portfolios of banks

Recommendation

The Committee further recommended that **a bank's investment portfolio should be bifurcated into two parts viz. " permanent investment " and " current investment "... and it should make full provision for depreciation in the value of current investments.**

Action taken

Permanent investment in securities is that part of investment which would be held till maturity and, therefore, be carried at book value; while current investment, which is held for trading should be carried at cost or market value, whichever is lower. This proportion was 70% to be classified as permanent and 30% as current for the period ended 1992-93, which continued upto the year ended March 31, 1995. As yield to maturity (YTM) on approved securities was increasing as also a need for a rapid transition to a fully marked to market basis of valuation of investments, on June 20, 1995, RBI reduced the ratio of ' permanent ' and ' current ' investments of banks in approved securities to 60:40 for the year ending March 1996. The

SOURCES:

10. Reserve Bank Of India , Bulletin, December 1997

ratio of 'permanent' and ' current ' investment of banks in approved securities was further reduced to 50:50 for the year ending March 1997 and for the year 1997-98 it was prescribed to be 40:60. 11

(c) Income Recognition, Assets Classification (IRAC) Norms and Non-Performing Assets :

Recommendation

A proper system of income recognition and provisioning is fundamental to the preservation of the strength and stability of the banking system. A proper asset classification has to precede this exercise. As per international practice, an asset is treated as " non-performing asset " (NPA)when interest is overdue for at least two quarters. In respect of such NPAs interest is not recognised as income on accrual basis but is booked as income only when actually received. The Committee, therefore, recommended that **interest on non-performing assets should not be booked as income on accrual basis.** For the purposes of provisioning, banks and financial institutions should classify their assets into following four broad groups:

(i) Standard Assets

(ii) Sub-Standard Assets

(iii) Doubtful Assets

(iv) Loss Assets

The Committee proposed that while RBI would prescribe clear and objective definition, but broadly stated, Sub-Standard Assets will be those, which will be exhibiting problems and would include NPAs for a period not exceeding two years. Doubtful Assets are those NPAs which remain as such for a period exceeding two years and would also include loans in respect of which instalments are overdue for a period exceeding 2 years. Loss Assets are those where loss has been identified but the amounts have not been written off. Provision of 10% of total outstanding in case of Sub-Standard Assets was recommended. In case of doubtful assets 100% of security shortfall and for loss assets 100% of outstandings was recommended.

Action taken

It was decided to implement the recommendation on prudential accounting norms such as income recognition, assets classification for bad and doubtful debts with certain modifications, in a phased manner over a three year period beginning 1992-93. The definition of non-performing assets has been tightened over a specified period of time. Banks have to classify assets into four broad groups : (a) Standard Asset, (b)

SOURCES:

11. Report on Trend and Progress of Banking in India, 1996-97 (July-June) , Reserve Bank Of India

Sub-Standard asset (c) Doubtful Asset and (d) Loss Asset. The provisioning requirements depending upon category of the asset have also been specified.

(v) Setting up of Special Tribunals

Recommendation

Banks and financial institutions face considerable difficulties in recovery of dues from clients and enforcement of security charged to them due to the delays in the legal processes. A significant portion of their funds is thus blocked in unproductive assets the value of which keep deteriorating with the passage of time. Banks also incur substantial amounts of expenditure by way of legal charges which add to their overheads. The question of speeding up the process of recovery was examined and the Committee was of the view that unless a proper judicial framework is established which could help banks and financial institutions in enforcing the claims against their clients speedily, the functioning of the financial system will be beset with problems. The Committee, therefore, regarded **setting up of the Special Tribunals as critical to the successful implementation of the financial sector reforms.**

Action taken

This recommendation has been accepted and Special Tribunals have been set up. In order to effect speedy recovery of loans, a new Act viz. ' Recovery of Debts Due to Banks and Financial Institutions Act ' was passed by the Parliament on August 10, 1993. The Act came into effect from August 17, 1993. Debt Recovery Tribunals have been set up at Delhi, Jaipur, Ahmedabad, Bangalore, Chennai, Guwahati and Patna with Appellate Tribunal at Mumbai.

(vi) Setting up of Assets Reconstruction Fund

Recommendation

The Committee also recommended the **setting up of a separate institution known as** ' Assets **Reconstruction Fund** ' **(ARF)** with the express purpose of taking over such assets from banks and financial institutions, which have already become bad and doubtful and subsequently following up on the recovery of the dues owed to them from the primary borrowers. The mechanism of Special Tribunals and ARF were intended by the Committee to facilitate recovery of dues from clients in respect of whom banks and DFIs had already taken a decision to recall the loan and proceed with the enforcement of security.

Action Taken

This recommendation has not been accepted. On the basis of our analysis it appears that a centralised ARF would be severely handicapped in its recovery efforts by lack of geographical reach which individual

banks possess. Secondly, follow up of non-performing assets will be more rigorous by the concerned banks when they are retained in their books rather than when they are transferred to another agency. Some other possible apprehensions have also been analysed by some economists like aspect of accountability, sharing of information and lack of empirical studies in this field. Some economists still consider ARF as " a better alternative than hasty write-off which erodes bank capital, and minimises the impact of rapid asset disposal on prices ('fire sale'). "12

(vii) Structural Organisation of the Banking System:

Recommendation

The broad pattern of the banking structure put forward by the Committee consisted of the following:

(a) 3 or 4 large banks (including the State Bank Of India) which could become international in character;

(b) 8 to 10 national banks with a network of branches throughout the country engaged in general or universal banking;

(c) Local banks whose operations would be confined to a specific region; and

(d) Rural banks (including RRBs) whose operations would be confined to the rural areas and whose business would be predominantly engaged in financing of agriculture and allied activities.

Action taken

Five banks were merged with other banks during the years 1993-94 to 1997-98. Steps were taken for restructuring and recapitalisation of Regional Rural Banks. The Union Budget of 1996-97 proposed setting up of new private local area banks with jurisdiction over two or three contiguous districts. In the guidelines subsequently issued, a minimum paid up capital of Rs. 5 crore was stipulated for such banks. In 1996-97, the Reserve Bank Of India granted ' in principle ' approval for establishment of three local area banks.

(viii) Entry of Private and Foreign Banks

Recommendation

The Committee recommended that freedom of entry in the financial sector be liberalised and new **banks in the private sector may be permitted provided they conform to the minimum start up**

SOURCES:

12. " BANK DEBT CARVE OUT -- THE ARF OPTION ", Jagirdar Brinda , Excerpt from the Paper presented in the Bank Economist Conference, 1997 , held during October 6-8, 1997 at Mumbai

capital and other requirements and the set of prudential norms with regard to accounting, provisioning and other aspects of operations. The Committee also recommended that there should not be any difference in treatment between the public sector and private sector banks. Strict compliance with the prudential guidelines laid down by Reserve Bank Of India togetherwith the relevant statutory requirements governing operations of private banks should provide adequate safeguards against misuse of bank's resources. It was also felt that entry of foreign banks would improve competitive efficiency of the Indian banking system as also upgrading work technology. The Committee, therefore, recommended that consistent with the other aspects of Government policy dealing with foreign investment, the policy of allowing foreign banks to open offices in India may be liberalised subject to statutory requirement of reciprocity and the maintenance of such assigned capital as may be prescribed by Reserve Bank Of India. Foreign banks, when permitted to operate in the country should be subjected to the same requirements as are applicable to domestic banks e.g. same social obligations as have been imposed on the domestic banks and it will ensure a level playing field.

Action taken

The guidelines for entry of private banks have been issued. Apart from the required minimum paid up capital of Rs. 100 crore and the prudential norms and the capital adequacy, their shares should be listed on stock exchanges. These safeguards are essential to promote healthy competition among banks so that the existing banks are not penalised. 13 Private and foreign banks have also to observe directions in regard to priority sector lending with modification allowed in the composition of such lending for an initial period of three years. Effective from April 1993, foreign banks were advised to increase their priority sector advances from 15% of their net credit to 32% by March 1994. Within the enhanced target of 32%, two sub-targets of 10% each in respect of advances to small scale industries and export sector were fixed. On November 4, 1996, the target of export credit was raised to 12% of net bank credit within the overall target of 32% to be achieved by end-March 1997. Thus endeavour has been made to provide a level playing field to different categories of banks to promote healthy competition.

SOURCES:

13. As regards entry of new banks, there are two schools of thought. Caprio and Summers advocate that banking industry should not be characterised by entry of new banks. ("Finance and its Reform: Beyond laissez-faire", Caprio G. & Summers L., Working Paper No. 1171, Washington DC World Bank, 1993). Gorton holds the same line of thinking when he says, " Entry by competitor reduces charter value since banks no longer have a monopoly on an important source of bank finance. Incumbent banks must then lower the interest rate they charge on loans; resulting in reduced profitability.... Without the incentive effect of a valuable charter, the level of bank risk-taking will increase. " (" Bank Regulations when 'banks' and 'banking' are not the same", Gorton, G., Oxford Review of Economic Policy Vol. 10 (4) pp. 106-119, 1994.

Sen and Vaidya, after examining the merits and demerits of the above viewpoints, conclude that " Therefore, the regulators can always allow new banks to enter, if it feels that the desired level of efficiency is not being observed in the banking industry." (" The Process of Financial Liberalization in India, Sen Kunal & Vaidya Rajendra R., Oxford University 1997 pp. 110-111)

(ix) Branch Licensing Policy :

Recommendation

The branch licensing policy in the pre-reforms phase, on one hand placed restrictions on commercial banks on opening offices purely on profitability considerations and, on the other hand, directed banks to open offices in centres with the objective of providing banking services specially in the rural and semi-urban areas "regardless of the fact that such branches are likely to be unremunerative." With the banking system having extended its branch network over a vast area of rural hinterland and successfully achieved an increase in banking density, the Committee proposed that **branch licensing be abolished** and Indian commercial banks should be given full freedom to open or close branches (other than rural branches for the present) or swap their rural branches with those of the other banks on the basis of their commercial judgment of the individual banks.

Action taken

The RBI's Branch Licensing policy for 1990-95 was changed in 1992 in response to Narasimham Committee recommendations. providing operational autonomy to banks to rationalise their branch network. Banks were permitted to shift their existing branches in the same locality, open certain type specialised branches, convert the existing non-viable rural branches into satellite offices, spin off business of a branch and open extension counters / controlling offices / administrative units without prior approval of RBI. In June 1994, banks were advised to open at least one specialised Agricultural Finance Branch in each state to adequately deal with high-tech agriculture financing where they are convenors of the respective State Level Bankers' Committee (SLBC). During the year ended March 1996, public sector banks had operationalised 136 specialised branches in 85 identified districts and 33 specialised branches in other districts to cater to the needs of SSI units. They were advised to operationalise 100 more specialised branches. Full freedom to open branches was given to the banks in 1995-96 who fulfilled the criteria such as (a) CRAR at 8%, (b) Minimum net owned fund at Rs. 100 crore, (c) Net profit for 3 consecutive years and gross NPA not exceeding 15% of total advances. This should be a welcome measure.

(x) Organisation, methods and procedures in banks

Recommendation

Flexibility of operations, productivity and efficiency of the banking system are a function of the organisational systems, methods and procedures followed by the banking system. While the form of internal organisational structure has been left to the judgement of the individual banks, the Committee has observed that branch is the cutting edge of the banking industry, where there is the direct interface with the customer. It is the functioning of the branch that is thus a measure of the efficiency of customer service. **Banks have, therefore, to give close attention to the organisation, staffing, work technology, work culture and attitudes of branch staff.**

Action taken

Customer service in the banking sector was perceived as an integral part of the overall financial sector reforms. Accordingly, Reserve Bank Of India initiated speedy action in 1992-93 relating to (a) advancing of working hours, (b) extension of business hours (c) acceptance of small denomination notes and (d) exchange of soiled and mutilated notes etc. 14 Banks were required to monitor and evaluate the 25 core recommendations of the Goipuria Committee on Customer Service in Banks. 15 For expeditious and inexpensive resolution of customer complaints against deficiency in banking services, the **Banking Ombudsman Scheme (BOS)** was introduced in June 1995. Ten Ombudsmen were appointed, one each at New Delhi, Mumbai, Bhopal, Bangalore, Chandigarh, Hyderabad, Patna, Jaipur, Kanpur and Guwahati. Four more Banking Ombudsmen were appointed during 1996-97 at Bhbaneshwar, Chennai, Calcutta and Ahmedabad and one more in September 1997 at Thiruvananthapuram taking the total number to 15 in the country.

(xi) Mechanisation and Computerisation:

Recommendation

In the services sector, machines and computers bring about a qualitative change in the nature of service and where time is an essential input in the quality of service, labours and machines cease to be substitutes and assume complementary roles. Computerisation must be seen as a measure to improve customer service and efficiency, which would lead to growth and thus help to expand employment. In the present competitive conditions, there would be need of greater measure of computerisation for providing efficient services by banks. Accordingly the Committee endorsed the recommendations of Rangarajan Committee on Computerisation of Banking Industry. Computerisation would lead to improved customer service and efficiency and would lead to growth.

Action taken

The banking sector, in general, is in the process of adopting state-of-the-art systems of information technology. Decks were cleared for further computerisation of banks following agreement with trade union in 1993. Measures have been taken by RBI to set up a Very Small Aperture Terminal (VSAT) Network to provide reliable communication to the financial sector as a whole. In addition, the telecommuications network is sought to be strengthened through the extensive use of the RBI Net / Bank Net. All public sector banks, foreign and private sector banks are connected to the network. In order to provide extended banking hours to the customers, many banks are going in for Shared Payment Network System (SPNS) and

SOURCES:

14. Report on Trend and Progress of Banking in India 1996-97 (July - June) 1997, Reserve Bank Of India

15. " Report of the Committee on Customer Service in Banks " headed by M.N. Goipuria

installation of Automated Teller Machines (ATMs). As of end-June 1997, 13 banks had participated with a total of 38 ATMs. In addition to these facilities, many banks were providing services like tele-banking, internet banking services and had become members of the Society for World-wide Inter-bank Financial Telecommunications (SWIFT). Such reliance on SWIFT is essential for banks dealing in foreign exchange for accessing international markets in a cost-effective manner.

In terms of the recommendations of the Committee on Technology issues relating to Payments System and Settlement System in the Banking Industry (also known as Saraf Committee) 16 , electronic Clearing Service (ECS) is operationalised at four metropolitan cities. Keeping in view its success, it has further been extended to other centres and has also been widened. The recommendations of Shere Committee on Electronic Funds Transfer 17 have been received and is being examined.

3.3 SECOND NARASIMHAM COMMITTEE ON BANKING SECTOR REFORMS IN INDIA

The reform process of financial sector is in progress in India for the last more than six years. During the period, there have been major changes in the macro economic environment, policy and institutional development. The Second Committee on Banking Sector Reforms 18 headed by Sri M. Narasimham was, therefore, appointed by the Government of India on December 26, 1997 to review the implementation of financial sector reforms and to look ahead and chart the reforms in the years ahead so that ***India's banking system can become Stronger and better equipped to compete effectively in a fast changing international economic environment.*** The Committee submitted its Report on April 24, 1998.

The Committee has looked at the second generation of reforms in terms of three broad inter-related issues:

* Strengthening the foundation of the banking system,

** Streamlining procedures, upgrading technology and human resource development,

***Structural changes in the system

SOURCES:

16. " High Powered Committee on Technological Issues relating to Payment and Settlement System", headed by W.S. Saraf, Report dated December 4, 1994

17. " Committee on Electronic Funds Transfer (EFT), Chairperson Smt. K.S.Shere, Report dated January 18, 1996.

18. Committee on Banking Sector Reforms, headed by M. Narasimham, appointed by the Government Of India on December 26, 1997 also popularly known as Second Narasimham Committee on Banking Sector Reforms. The Committee submitted its Report on April 22, 1998, RBI Newsletters dated 31st May 1998 and 15th June 1998

(i) *Capital Adequacy:*

(a) Pending the emergence of markets in India where market risks can be covered, it would be desirable that capital adequacy requirements take into account market risks in addition to credit risks.

(b) In the next three years the entire portfolio of Government securities should be marked to market.

(c) At present Government and other approved securities are subject to a zero risk weight. It would be appropriate that there should be a five percentage weight for market risk for Government and approved securities.

(d) There is an additional capital requirement of 5% of the foreign exchange open limit. Such risks should be integrated into the calculation of risk weighted assets. The foreign exchange open position limits should carry a 100 percent risk weight.

(e) The minimum capital to risk assets ratio be increased to 10% from its present level of 8%. It would be appropriate to phase the increase. An intermediate minimum target of 9% be achieved by the year 2000 and the ratio of 10% by 2002.

(ii) *Asset Quality, Non-Performing Assets:*

(a)An asset be classified as doubtful if it is in the sub-standard category for 18 months (to be reduced from 24 months at present) in the first instance and loss if it has been so identified but not written off.

(b) Banks and financial institutions should avoid the practice of " evergreening " by making fresh advances to their troubled constituents only with a view to settling interest dues and avoiding classification of the loans in question as non-performing assets.

(c) The Committee has observed that recapitalisation is costly and, in the long run not a sustainable option. No further recapitalisation of banks be undertaken by the Government. As the authorities have already proceeded on the recapitalisation route it is perhaps not necessary to consider *de novo* the institution of an Asset Reconstruction Fund (ARF).

(d) The objective should be to reduce the average level of **net** NPAs for all banks to below 5% by the year 2000 and to 3% by 2002. For those banks with an international presence the minimum objective should be to reduce **gross** NPAs to 5% and 3% by the year 2000 and 2002 respectively and net NPAs to 3% and zero percent by these dates.

(e) Directed credit has a proportionately higher share in NPA portfolio of banks and has been one of the factors in erosion in the quality of bank assets. There is continuing need for banks to extend credit to agriculture and small industrial sector, which are important segments of the national economy, on commercial

considerations and on the basis of creditworthiness. The branch managers of banks should be fully responsible for the identification of beneficiaries under the Government sponsored credit linked schemes.

(iii) **Directed Credit :**

The interest subsidy element in credit for the priority sector should be totally eliminated and even interest rates on loans under Rs. 2 lakh should be deregulated for scheduled commercial banks as has been done in the case of regional rural banks and cooperative credit institutions. It is the timely and adequate availability of credit rather than its cost which is material for the intended beneficiaries.

(iv) ***Prudential Norms and Disclosure Requirements :***

(a) With regard to 'income recognition concept' of banks in India, income stops accruing when interest or instalment of principal is not paid within 180 days. We should move towards international practices in this regard and recommend the introduction of the norm of 90 days in a phased manner by the year 2002.

(b) At present, there is no requirement for a general provision on standard assets . A general provision of, say, 1% may be considered for introduction in a phased manner. There is a need for disclosure in the balance sheet of banks in a phased manner of the maturity pattern of assets and liabilities, foreign currency assets and liabilities, movements in provision account and non-performing assets.

(c) There is a need for disclosure, in a phased manner, of the maturity pattern of assets and liabilities, foreign currency assets and liabilities, movements in provision account and non-performing assets. Full disclosure would be necessary to enable a bank's creditors, investors and rating agencies to get a true picture of its functioning - an important requirement in a market driven financial sector.

(c) Banks should also pay greater attention to asset liability management. to avoid mismatches and cover, among others, liquidity and interest rate risks.

(d) Banks should be encouraged to adopt statistical risk management techniques like Value-at-risk in respect of balance sheet items which are susceptible to market price fluctuations, forex rate volatility and interest rate changes.

(v) ***Systems and Methods in banks:***

(a) An area requiring close scrutiny in the coming years would be computer audit, in view of large scale usage and reliance on information technology.

(b) There is need to institute an independent loan review mechanism specially for large borrowal accounts and systems to identify potential non-performing assets (NPAs).

(vi) *Size of workforce:*

Steps must be taken to measure the adjustment in the size of workforce of banks by the individual banks to remain efficient, competitive and viable. The management of Indian banks should review the changing training needs keeping in view their business environment.

(vii) *Information technology in banks:*

Globally, banking and financial systems have undergone fundamental changes because of the ongoing revolution in information and communication technology. Information and control systems need to be developed in several areas like better tracking of spreads, costs and NPAs for higher profitability; accurate and timely information for strategic decisions to identify and promote profitable products and customers; risk and asset-liability management; and efficient treasury management.

(viii) *Weak banks:*

A 'weak bank' should be one whose accumulated losses and net NPAs exceed its net worth or one whose operating profits less its income on recapitalisation bonds is negative for 3 consecutive years. The potentially revivable banks should be nurtured into healthy units by slowing down on expansion, eschewing high cost funds/borrowings, judicious manpower deployment, recovery initiatives and containment of expenditure etc.

(ix) *New Banks:*

The policy of licensing new private banks (other than local area banks) may continue. The start up capital requirements of Rs. 100 crore were set in 1993 and these may be reviewed.

Thus the Committee has covered a large number of areas and made several important recommendations for enhancing the effectiveness and efficiency of the banking system. The recommendations are being examined by the appropriate authorities.

3.4 CONCLUSION

Thus the recommendations of Narasimham Committee on Financial Sector Reforms have been very crucial for banking sector in India. These recommendations, which were submitted in November 1991 have

changed the course of banking in India and that is why the period thereafter is also termed as 'Reforms Phase.' These recommendations have rightly centered around efficiency, competitiveness, viability and functional autonomy but coupled with prudential norms.

The directed investment in the shape of Statutory Liquidity Ratio and Cash Reserve Ratio have been reduced to reasonable levels and lendable resources of the banks have been set free to a great extent for utilisation with their commercial judgement. The rate of interest on Government securities is also nearly market-related and this will ensure reasonable returns on Government securities to banks. While target of 40% for directed credit in the shape of priority sector lendings has not been reduced due to imperfections in the credit market and significance of these sectors in the economy, element of subsidisation has been reduced and lending rates only upto Rs. 2 lac are administered and area of priority sector lending has been enlarged.

The introduction of prudential norms like capital adequacy ratio of 8% against risk-weighted assets has raised equity base of commercial banks. On one hand, it has provided cushion against losses, on the other hand, it has given them greater strength in the eyes of investors, customers and international rating agencies. There is some criticism of this formula by calling it ' one size fits all ' formula. The answer to this question is that it is the minimum prescribed rate and management of banks can always self-prescribe for themselves a higher ratio. While it will be rare that weak banks will prescribe a higher rate, the merit in the approach is that it is better to have a prescription of internationally acceptable rate than a regime where no rate is prescribed. Sometimes a suggestion is made that Government banks may be exempted from such norms but it is not acceptable as all the banks are commercial entities and their functioning involves management of risks. Capital is a cushion against losses and intrinsic commercial element is the same for each commercial bank whether Government owned or private sector. But CAR is effective when it is backed by proper disclosure. For this purpose, the Committee also recommended for proper classification of Government securities and their proper valuation and provisions on the basis of their classification as ' current ' or ' permanent '.

Non-Performing Assets (NPA) are another critical factor for banks. These are known as unproductive assets, which neither earn income nor the funds blocked therein can be cycled for productive purposes. While it will take some time to know the impact of Special Debt Recovery Tribunals set up by the Government towards recovery of bank dues, banks will have to gear up their recovery machinery as a curative measure in addition to required prevent measures like proper appraisal of credit, pre-sanction and post-sanction surveys, follow up of bank credit to ensure end use of funds and diagnosing signs of even incipient sickness. NPAs have to be substantially reduced so that they come to international standard of around 5% NPA of net bank credit. A clean balance sheet will provide them greater strength.

Technological progress coupled with latest information technology are essential for excellence in customer service and effectively meeting competition offered by foreign banks and new private banks. Customer satisfaction, customer focus, relationship banking, customer retention, product innovation, customization and quality circles have become the buzz words pointing at one direction and the only direction i.e. customer service. Banking Ombudsman Scheme should be used only as a matter of last resort.

Banks have to be governed by the consideration of economic viability. They have to weigh every function in terms of profitability . If a branch has to be opened , its economic viability must be assessed. If it is lending, the techno-economic feasibility and element of risk has to be assessed. Costing and pricing of services have be done properly so that bank's schemes do not become losing propositions. Branches are the profit centres and if loss is being incurred, it means that correctives are required. All the components of business, expenditure, and income, justification of staff strength and strategies for attaining break-even point have to be analysed. It is crucial that there is no ' zero risk ' concept for banks because they can only measure and manage risks. Lending is a part of their conventional business and they have to fulfill their obligation of efficient allocation of resources. This is more important in the context of recent deceleration of bank credit, where it is argued that banks prefer Government securities as these are risk-free as compared to advances which involve risk. While banks must not indulge in ' adverse selection ', they should undertake healthy loaning. Ultimately banks prosper, when the economy prospers. Financial sector reforms have given a proper perspective to the banks to properly face the challenges efficiently and effectively in the present complexities.

In the next chapter, we shall analyse the impact of reforms and consequent liberalisation, competition, deregulation, globalisation and computerisation on the profitability of commercial banks, in general and public sector banks, in particular.

---- - - ----

Chapter IV

PROFITABILITY AND EFFICIENCY OF COMMERCIAL BANK IN INDIA

Chapter IV

PROFITABILITY AND EFFICIENCY OF COMMERCIAL BANKS IN INDIA

4.1 THEORETICAL BACKGROUND

Profit is an indicator of health of a commercial organisation. Not only growth of such an organization but also its very existence is linked to profits. " Profits", says J.B.Clark " are said to be both causes and effects of economic dynamics." In a static state there is no risk and no uncertainty and hence no profit. But we live in a changing world and element of change makes us enterprising, farsighted and innovative. Hawley 1 defines profit as a reward for risk-taking. Risk-taking is, no doubt, an important factor affecting profit but other factors too affect profit like innovations, overall economic situation, competition and infra-structure etc. Prof. Knight 2 links profit with 'uncertainty-bearing' (which refers to unforeseeable risks.). This element attracts a supply price and unless certain return is expected, no entrepreneur will be induced to face uncertainty. This theory is criticised on many grounds. Uncertainty is not the only factor which limits the supply side of entrepreneurship. Other factors like availability of funds, technology, infrastructure, macro-economic setting and a host of other factors decide the supply line. Moreover, uncertainty is not an acceptable term as commercial organisations can and they should be in a position to estimate profits ex-ante. Therefore, Knight's theory of profit is divorced from empirical relevance. Joseph Schumpeter 3 gave the theory of profit a progressive touch, when he linked it with innovations stating that the principal function of entrepreneur is to make innovations and profit is a reward for this important function. Innovations can be grouped into two categories (a) first, which change the production function and thereby reduce the cost of production and (b) second, which stimulate the demand function or to call it utility function. The first category is linked with new raw materials, improved new techniques or processes or a new or better organisational pattern.

The second category is product linked or market linked or advertisement linked. But innovational profits are of short term nature and disappear due to competition or imitation from others. The theory has two basic deficiencies: first it highlights only one aspect of profit generation and secondly the fruits

SOURCES:

1. " Enterprise and Productive Process ", Hawley F.B. , 1907

2. " Risk , Uncertainty and Profit ", Knight Frank H. , Houghton Muffin , Boston 1921

3. " The Theory of Economic Development ", Schumpeter Joseph, Harvard University Press, Cambridge, Mass. 1934

of innovative techniques can not be so short termed.

Some economists contend that there is an inherent conflict between the interests of the individual entrepreneur and social welfare or between 'private net product' and 'social net product', as Pigou, 4 the Cambridge economist had put it. This theory does not present things in a proper perspective. Profit, in fact, performs an important finction by ensuring viable performance of a unit and acts as a yardstick for efficient allocation of economic resources, which are scarce and have alternative uses. A unit has also to provide for future technological progress and diversification and it can do so by generating and retaining profit. It can, therefore, be said that profits, by playing an important role in the market mechanism, serve a social purpose. Here speculative profits are beyond our purview.

Some economists term profit as residual income. But profit is more than a residual income. It is the net result of the working of a commercial organisation and as such becomes a tool of analysis for the financial experts, lenders and investors to examine the economic viability and efficiency of a commercial organisation. Profit is, in fact, an important yardstick for efficient allocation of resources through market mechanism.

Unlike rewards for other factors of production, profit may have sharp fluctuations due to fast changing economic scenario within the country and globally. Profit, if not properly planned, may turn negative.

Taking a comprehensive view from all the above theoretical angles, profit has the following important elements :

(a) a reward for *risk-bearing*,
(b) a reward for *uncertainty-bearing*,
(c) a cause and effect of economic dynamics ,
(d) a reward for innovation ,
(e) a social dimension of its role in meeting growing and multi-faceted requirements of the society, which only a profitable organisation can fulfil. Besides, they serve a useful purpose in the market mechanism by ensuring allocative efficiency of resources,

(f) A useful tool of analysis for examining economic viability of the organisation by financial experts, lenders and investors.

(g) Unlike rewards for other factors of production, it may have sharp fluctuations and may even be negative in adverse circumstances, if not properly planned.

When we apply the above elements of profit to the banking sector, we observe that risk is an unavoidable part of banking, may it be business risk or fluctuations in interest rates or foreign exchange rate

SOURCES:

4. " Economics of Welfare ", Pigou A.C. , Mc Millan , London , 1961

or liquidity risk. Eliminating risk is not possible ; managing risk is. 5 Assessing and managing risks of various types by banks like interest rate risks, credit risks, liquidity risks, fraud risks, foreign exchange rate risks etc. are very crucial in the modern banking so that banks have stability and their operations are economically-viable. As a net result of the working of a banking company, it serves as an important tool of analysis. In the modern world of computerisation and information technology, innovations have assumed a greater role than ever before.

Gurley and shaw 6 have adduced the following reasons in support of profitable functioning of the banking system :

(i) The banking system will not produce ' any real volume of money ' that implies operating losses in the long run. In other words, banks will not extend credit or undertake such intermediation activities which result in losses.

(ii) The revenues and cost affect the banks' response even to the central bank's prodding for monetary expansion.

(iii) The bank's choice between different types of primary securities when they expand or contract credit is dictated by profit considerations.

(iv) The profit experience of private banks affects their ability to accumulate net worth either by capital issue or retention of earnings. An unfavourable record has the result of weakening bank solvency and so compromising ' the moneyness of bank deposits' that closer surveillance of bank operations is required and even public subvention is necessary. By moneyness of deposits, Gurley and Shaw mean safety of bank deposits and crisis of confidence in depositors may be quite adverse for the banks.

(v) Profit experience in banks has a great deal to do with the structure of industry and with the competitiveness of its behaviour on the markets for bond and credit. Adverse profit experience for the industry as a whole puts a premium on non competitive banking practices.

(vi) Profit experience of private banks affects incentives and resources to undertake technological development in the industry for long run improvement in the efficiency of payments mechanism.

(vii) Where the banks have to elect among Government securities for meeting statutory obligations they prefer the most profitable ones.

SOURCES:

5. " Commercial Lending ", Ruth George E. , American Bankers' Association , Washington DC, USA, 1995 Page 49

6. " Money in a Theory of Finance", Gurley John G. & Shaw Edward, The Brookings Institution, 1968 Edition, pp. 281-283

Thus profitability is the guiding factor for almost all the operations of banks and this gives them strength and customers' confidence and better rating by the rating agencies if coupled with other strong efficiency parameters.

4.2 PROFIT AS AN ACCOUNTING CONCEPT

Profit / loss is an item of Profit / Loss Account for the accounting period. Profit is the absolute difference between total income (T I) and total cost (T C) during a specified year normally an accounting year. If Profit is signified by P and Loss by L , these can be expressed by the following expression:

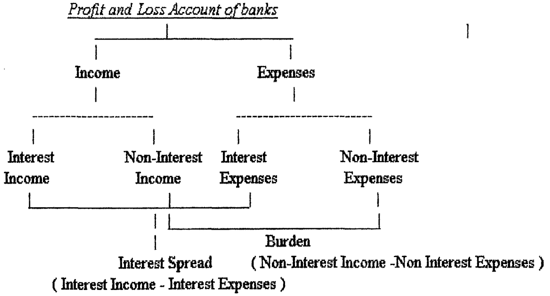
$$P = TI - TC \quad (\text{if } TI \text{ is} > TC)$$
$$L = TC - TI \quad (\text{if } TI \text{ is} < TC)$$

A bank is a business firm that has revenue and cost finctions like any other business. This point can be illustrated by the following equation :

$$\text{Profit } (P) = R(Q) - C(Q)$$

Where Q = output of the bank , R = revenue to the bank by selling the output
C = cost to the bank for producing and selling the output. Revenue is a finction of output, as the amount of revenue earned by the bank depends on the amount of output produced and sold.
Costs are also a finction of the level of output. 7

The profit and loss of banks can also be depicted by the following tree:



SOURCES:

7. " Money, the Financial System and Monetary Policy ", Cargill Thomas F. , Prentice Hall , New Jersey 1986 Edition , Page 83

As banks basically deal in funds (non-fund based business will be examined later), ***interest*** is most powerful factor in the profit and loss account. The differential between interest earned and interest paid is known as ***' net interest income ' or ' interest spread.*** All other earnings are clubbed as ***'non-interest earnings'*** and all other expenses are clubbed as ***' non-interest' expenses.*** The differential between non-interest earnings and non interest expenses is termed as ***' burden '*** in banking parlance.

The above factors have been expressed in the following manner so that equation in respect of bank profit components can be formulated:

4.3 PROFIT & LOSS ACCOUNT

Surplus/Deficit/Cost	Income	Expenditure
Interest Spread (S) S = A - C	Interest Income (A)	Interest Expended (C)
Burden (B) (B) = D - (W + O + PC)	Other Income (D)	(1) Wages (W) (2) Other Operating (O) Expenses (3) Provisions & (PC) Contingencies
Profit/Loss P = (I-E) or (E-I) Alternatively, P = (S-B)	Total Income (I) I = (A+D)	Total Expenditure (E) E = (C) + (W+O+PC)

Thus ' interest spread ' and ' burden ' are two important factors in determining bank profits.

The various constituents of total income and total expenditure at the 'whole bank level' are given below under different heads :

4.3. 1 S O U R C E S O F I N C O M E

(Whol e Bank Level)

Interest Income

-- Interest on loans and advances
-- Interest on discounting of bills
-- Interest on investments
-- Interest on funds with Reserve Bank Of India

-- Interest on funds with other banks
-- Interest on other items

Other Income

-- Exchange earned on remittances like draft, telegraphic transfers
-- Commission on Government business
-- Commission on non-fund based business like letter of credit, bank guarantees
-- Rental on custodial services like safe deposit lockers and safe deposit articles
-- Income on collection of proceeds of financial instruments
-- Remuneration on foreign exchange business
-- Dividend from subsidiaries and joint ventures
-- Profit/loss on sale of investments and revaluation of investments
-- other items

4.3.2 ITEMS OF EXPENDITURE

(at whole bank level)

Interest cost

-- Interest paid on deposits
-- Interest paid on borrowings
-- Interest paid on refinance received from the central bank / designated financial institutions

Non-Interest cost or Operating expenses

-- Manpower Expenses
Salary and allowances etc. paid to staff
-- Overheads
-- Premises and equipment maintenance cost etc.

Provisions and Contingencies

Part I

(i) Provision for bad and doubtful advances
(ii) Bad advances written off
(iii) Provision for depreciation of investments
(iv) Provision for contingencies

Part II

(I) Provision for income tax
(ii) Provision for interest tax

Part III

Other reserves

4.4 CONCEPTS OF PROFITABILITY AND PRODUCTIVITY

The terms Profit, *Profitability and Productivity* are interrelated but connote different aspects of strengths or weaknesses of an organisation. As compared to the profit concept, which implies an absolute value; profitability is a ratio analysis, which interrelates the variable of profit with another variable, say, to working funds or assets or equity etc. Profitability connotes performance specifically from profit angle e.g. ratio of gross profit / loss to total assets or ratio of net profit / loss to total assets etc. But the above ratios may not be sufficient as an organisation may require performance analysis from different angles and as such *Efficiency Parameters* have been evolved. Efficiency parameters are linked with various dimensions of business e.g. prudential norms like ratio of net non-performing assets to net credit and ratio of capital (Tier I and Tier II) to risk-weighted assets. Net NPAs reflect the health of advances and also affect recycling of funds and generation of interest income. Capital adequacy ratio acts as a cushion against losses.

As regards the concept of productivity, it is easier to define in case of manufacturing industries, where output is physical. A systematic approach for measurement of productive efficiency had its genesis in the works of Debreu. 8 He linked productive efficiency with ' coefficient of resource utilisation.' The thrust of efficiency was either maximum feasible equiproportionate reduction in all variable inputs or maximum feasible equiproportionate expansion of all outputs. Although measurement of productivity is difficult in banking, which is a multi-product service industry, still the above concept is useful as it gives input and output dimensions involved in measuring productivity. The labour input can be measured in banking sector in terms of total wage bill and other benefits payable under the Service Rules of employees . The manpower expenses representing labour input works as denominator of the productivity equation. The productivity ratios may be business per employee, profit per-employee etc. But productivity Ratio may vary to a great extent depending upon various situations e.g. at micro level volume of business per employee may be much higher at branches handling large corporate accounts at metropolitan centres than at rural or semi-urban branches handling smaller accounts.

SOURCES:

8. " The Coefficient of Resource Utilisation " , Debreu G. , Econometrica , Volume 10, No. 3 , July 1951 pp. 273-292

4.4.1 *BACKWARD LINKAGES PROCEDURE :* 9

Variable to be controlled	Primary Factors	Secondary Factors	Tertiary factors	Fourth Associate Factors
PROFIT BEFORE TAX	SPREAD	Interest Earned	(1) Total earning assets (2) Composition of earning assets (3) Yield on each type of asset	(1) Government & RBI policies (2) Competition & cooperation among banks (3) Quality of Asset Management decisions
		Interest Paid	(1) Total interest paying liabilities (2) Composition of interest paying liabilities (3) Interest rate on each component	(1) Government & RBI policies (2) Competition & Cooperation among banks (3) Quality of liability management decisions
	BURDEN	Non-Interest Income	(1) Range & volume of services (2) Service charges	(1) Competition among banks (2) Delegation of powers to managers (3) Service Charges
		Man-power Expenses	(1) Number, seniority & composition of employees (2) Salary structure	(1) Recruitment, promotion & placement policies (2) Wage agreements & policies
		Other Expenses	(1) Nature & volume of business (2) Systems and procedures	(1) Quality of expenditure decisions (2) Budgeting and cost control

SOURCES:

9. " Profitability of Commercial Banks ", Varde Varsha S. and Singh Sampat P., 1983, National Institute Of Bank Management , Bombay pp. 2-20

A number of factors have an impact on the profitability of banks. Some of them may be endogenous; while others may be exogenous. In order to identify the factors in sequence and in the order of their importance , which affect profitability of banks, the backward linkages procedure has been evolved. In this process the variable to be controlled is first identified. In the second stage, the primary factors are located. Then tertiary factors and fourth associate factors are grouped . We have added to this list supplementary factors, which include non-banking financial intermediaries, development financial institutions, capital market and global markets and have a strong bearing on the variable to be controlled i.e. net profit of banks. By making deeper analysis, adequate steps can be taken both by the banks and the central bank and the Government to maintain and strengthen viability of banks.

The above technique is useful for identifying the exogenous and endogenous factors having a bearing on banks profits but a few more crucial factors have an important bearing on banks' profits, which have been developed by us as ' supplementary factors.'

4.4.2 SUPPLEMENTARY FACTORS : (as a supplement to backward linkages)

In the present scenario, the concept of ' universal banking ' is gaining acceptability and competition to the banking sector is forthcoming not only among the banks themselves but also from other financial intermediaries like non-banking financial intermediaries (NBFCs) and developmental financial institutions (DFIs). With the process of disintermediation setting in with the introduction of commercial paper (CPs), the equity market also has an important bearing on credit market . Banks are also increasingly undertaking the activities of merchant banking and managers to the new capital issues etc. As such stock market condition affects their fee-based income. Morever, due to globalisation of the economy, the cost and return of funds in the international markets has an important bearing on the banking sector. Induction of information technology and computerisation are helping in evolving new financial instruments . These aspects have to be properly considered by the banks while undertaking their profitability exercise.

4.4.3 BALANCE SHEETS OF COMMERCIAL BANKS

A commercial bank, being a commercial organisation, prepares a balance sheet in addition to profit and loss account. This financial statement helps in analysing ratios pertaining to their assets and liabilities. Important items of the bank balance sheet are given below:

(1) LIABILITIES

(a) Capital and reserves

For the purpose of initiating business, capital is inducted in the organisation as owner's stake. Capital and reserves are the ultimate cover against losses. In 1988 an exercise was undertaken to relate capital to the risk of the portfolio of the assets held by a bank. The origin of the prescription of Capital Adequacy to Risk-Weighted Assets (CRAR) goes back to the Basle Committee Report of the Bank of International Settlements

(BIS) published in 1988. In the early eighties, the competition in financial sector increased and also there was growth of new off-balance sheet instruments leading to increased risk exposure of banks. It led to prescription of a minimum of 8% capital to risk weighted assets ratio. "Capital", says Dr. Rangarajan, " gives owners and managers powerful incentives to run the bank safely and soundly. The bank's capital ratio is seen by the investment community and rating agencies as a sign of strength and, at the same time, it provides flexibility for future business growth. If Government banks are exempt from complying with capital adequacy ratios, they will be at disadvantage as compared to other banks particularly in their foreign exchange and international operations as it is not possible for the foreign banks and rating agencies to assess their solvency properly." 10 The capital base of banks in India has been examined subsequently in this chapter in the context of banking sector reforms.

(b) ***Bank Deposits***

The bank's main liability consists of deposits. Bank deposits provide the base for operations of the banks, which traditionally have been creators of credit. Deposits are, in fact, borrowed money as far as banks are concerned and are either repayable on demand or payable after specified time. Demand deposits require higher liquidity, whereas time deposits require lesser liquidity to be maintained by banks. Wilson 11 states that " the fixed or term deposit may impart some degree of inertia to deposit structure since many people, who have placed their money for a stated term will feel bound to observe the contract. Further, there is deterrent, at least, a partial loss of interest" in case of pre-mature withdrawal of deposit. As regards Certificate of Deposits (CDs), Wilson terms them as ' wholesale or bought money .' This process started in America in 1960s and was greatly assisted by the fact that CDs became negotiable instrument (whereas term deposits are not-transferable) and a secondary market began to develop. As CDs are high cost deposits and as sufficient low cost funds were available in Indian financial markets, the outstanding amount of CDs mobilised by banks declined from Rs. 16,316 crore in March 1996 to Rs. 12,134 crore in 1996-97.

(2) *ASSETS*

(a) *Cash and balances with other banks*

The essence of banker customer relationship is an undertaking on the part of the bank to provide customers with cash on demand or after a stated period depending on the nature of the deposit. One of the purposes of reserve requirements is to ensure liquidity. Cash is most liquid of bank's assets but it does not earn income. Banks, therefore, manage with fine cash balance ensuring at the same time that Cash Reserve

SOURCES:

10. Excerpts from the inaugural address given by Dr. C. Rangarajan , ex- Governor, Reserve Bank Of India, in the Bank Economists' Conference (BECON) 1997 organised by Bank Of India , at Mumbai on October 6-8 , 1997

11. " Banking Policy and Structure , a Comparative Analysis ", Wilson J.S.G., Croom Helm Ltd., Sydney, Australia, 1986 Edition, pp. 228-233

Requirements are fulfilled. But cash management is not only managing the cash, it also has a broader connotation. Cash management must cover the spectrum of various transactions handled by the bank to ensure that (a) all the amounts due to the bank have been received in time, (b) reimbursement of funds in respect of payments made by the bank as an agent on behalf of the principal (known as agency arrangements) have been received, (c) reporting system for funds settlement are working smoothly, (this assumes significance in view of large number of branches and heavy transactions involved) (d) and settlement of funds takes place within the specified time limit. It will ensure that funds are not held up in the pipeline and are available to the bank for utilisation on proper remuneration and bank has not to pay any penalty for default.

(b) Investments

Bulk of the investment made by the banks are in Government securities in order to ensure compliance of statutory reserve requirements. But with the changing time, fund management departments of banks should not be treated as mere compliance centres. Judicious portfolio management is also a source of profit. Government securities normally do not cover any risk but the yield may be lower. Moreover, maturity profile of securities is important so as to ensure proper matching of assets and liabilities. The market related rates of interest on Government securities and development of secondary market are also important for making the securities portfolio active and attractive.

(c) Loans and advances

Among the assets in the balance sheet of a bank, loans and advances constitute the core of a bank's earning assets. It is usually this group of assets, which is most profitable. It is for this reason that interest spread constitutes most important factor for bank's profit. But loans have another dimension too. They carry an element of credit risk and normally involve a higher monitoring cost. Banks have to guard against what Stiglitz 12 and Weiss termed as " adverse risk selection effect", under which, due to an increase in interest rates, a higher proportion of borrowers with riskier projects come forward for the loan and probability of default on loans also increases. As a solution, credit rationing is proposed by the abovenamed economists but it may not be a feasible proposition as it will depress market mechanism. Financial liberalisation, has, therefore, been advocated by McKinnon 13 and Shaw, 14 but these have to be accompanied with prudential norms. A balance has also to be struck between risk and yield so that banks have a healthy loan portfolio. Non Performing Assets represent unhealthy proportion of bank's loans and also affect income generation by banks as interest earned on NPAs is treated as income only on realisation basis and not on accrual basis resulting in decline in profitability or even losses.

SOURCES:

12. " Credit Rationing in Markets with Imperfect Information ", Stiglitz. J.E. and Weiss , American Economic Review , Vol. 71, No.3 1981, pp. 393-410

13. Ibid.
14. Ibid.

4.5 IMPORTANT RATIOS TO ASSESS PROFITABILITY, PRODUCTIVITY AND EFFICIENCY OF BANKS

(1) Interest Spread Ratio (ISR) $= \frac{\text{Interest Spread} \times 100}{\text{Total Assets}}$

ISR represents the Net Interest income as percentage of total assets.

(2) Gross Profit Ratio (GPR) $= \frac{\text{Gross Profit} \times 100}{\text{Total Assets}}$

GPR represents Gross Profit as percentage to total assets

(3) Net Profit Ratio (NPR) $= \frac{\text{Net Profit} \times 100}{\text{Total Assets}}$

NPR represents Net Profit as percentage to total assets. It is also known as Return on Assets Ratio (ROA).

(4) Return on Equity (ROE) $= \frac{\text{Net Profit} \times 100}{\text{Equity}}$

ROE (Net Profit in relation to equity) ratio reflects the earning capacity of the shareholder equity . It can also be expressed as Earning Per Share (EPS), where net profit during the year is divided by number of shares.

(5) Intermediation Cost Ratio (ICR) $= \frac{\text{Intermediation Cost} \times 100}{\text{Total Assets}}$

Intermediation cost is defined as other operating expenses excluding interest expenses and provisions and contingencies. Lower intermediation cost ratio is a positive factor for increasing profitability.

(6) Asset Utilisation Factor (AUF) $= \frac{\text{Total income} \times 100}{\text{Average Assets}}$

It shows the level of income earned for a given level of assets indicating the utilisation of assets.

(7) Non-Performing Assets to Net Advances $= \frac{\text{Net Non-Performing Assets} \times 100}{\text{Net Advances}}$

The comparative position will show the quality of bank advances. This assumes significance in the context of IRAC norms introduced. A higher proportion of NPAs adversely affects banks' profits.

(8) Average Business Per Employee = $\frac{\text{Average Deposits + Average Advances}}{\text{Total Number of employees}}$

This shows productivity of the employees in the bank in terms of business. Average deposits per employee and average advances per employee can also be separately worked out.

(9) Net Profit per employee = $\frac{\text{Net Profit}}{\text{Total Number of employees}}$

This shows average net profit contribution per employee

(10) Capital Adequacy Ratio = $\frac{\text{Tier I + Tier II Capital} \times 100}{\text{Risk Weighted Funded or Non-Funded Assets}}$

It is an important part of prudential regulation and banks have to maintain 8% CAR in tune with prescription of the Bank for International Settlements (BIS).

(11) Credit Deposit Ratio = $\frac{\text{Total or Average Advances} \times 100}{\text{Total or Average Deposits}}$

This ratio reflects the proportion of transformation of deposits mobilised by banks into advances.

(12) Investment Deposit Ratio = $\frac{\text{Total or Average Investments} \times 100}{\text{Total or Average Deposits}}$

This indicates the level of the placement of resources mobilised for investment in Government and other securities.

The above ratios provide a tool of analysis to assess the profitability and productivity and other dimensions of the functioning of a banking company. These ratios contain factors both from profit and loss accounts and also from balance sheets of the banks. These ratios have to be compared to assess the progress over a period of time or during a particular phase. The comparative data of different banking groups show their weaknesses or strengths.

4.6 APPLICATION OF PROFITABILITY, PRODUCTIVITY AND EFFICIENCY PARAMETERS TO COMMERCIAL BANKS IN INDIA

4.6.1 Objective of Commercial Banks : Profits Vs. Social Obligations

As regards objective of banks, Cargill 15 asserts that the bank's objective is to make profit. But

SOURCES:

15. Ibid.

nationalisation of banks in India gave another dimension to the objective of banks and it was termed as 'social objective' or 'social purpose' as already been examined in Chapter II. The studies by Greenbaum 16 and Hestler 17 are also directed towards the social concept of efficiency in resource utilisation by assigning appropriate weightage to this aspect in the services provided by the banks. The amount of resources used to provide a given quantity of banking services, evaluated in terms of its social value, provides a measure of social efficiency.

Chakravarty Committee 18 took a comprehensive view when it stated in its Report that " The concept of operational efficiency of a commercial bank in India is associated with such diverse aspects of its operations as cost effectiveness, profitability, customer service, priority sector lending, mobilisation of deposits and deployment of credit in the rural and backward regions and so on. Operational efficiency has thus achieved a wider connotation."

4.6.2 *DECLINING TREND OF PROFITABILITY OF COMMERCIAL BANKS IN INDIA IN THE POST- NATIONALISATION AND PRE-REFORMS PHASE*

Nationalisation was a turning point in the history of banking sector in India. It gave banking a different dimension. The impact of the silent banking revolution, in general, in the pre-reforms phase has been examined in the previous chapter. We have seen that (a) rising proportion of low yielding assets in the form of Government securities and priority sector lendings, (b) rising proportion of high cost deposits (c) depression in interest income due to directed investments in the shape of high SLRs and CRRs and (e) deterioration in the quality of the loan portfolio both to the priority sectors and to the traditional sector were responsible for erosion of earnings and profitability of banks.

4.7 BANKING SECTOR REFORMS IN INDIA

In view of the problem of the declining profitability of commercial banks and other factors, Narasimham Committee on Financial Sector Reforms was set up and it submitted its Report in November 1991. The Committee observed that the decline in profitability emanated both from factors operating on the side of income and on the side of expenditure of the banking industry and the recommendations of the Committee and action taken thereon have been examined, in detail, in the previous Chapter.

SOURCES:

16. " Competition and Efficiency in the Banking System : Empirical Research and its Policy Implication ", Greenbaum Stuart I., Journal of Political Economy , August 1967, Volume 75, No. 4 pp. 461-477

17. " Indian Banks : Their Portfolio, Profits and Policy", Hester Donald D. , Bombay University Press, 1961

18. Ibid.

4.8 WORKING RESULTS Of PUBLIC SECTOR BANKS IN THE POST - REFORMS PHASE

4.8.1 ANALYTICAL FRAMEWORK

The analytical framework has been developed on the basis of (a) Income, Expenditure and Net Results taken from the Profit & Loss Accounts and (b) assets and liabilities contained in the Balance Sheets in respect of the selected banks and also Group-wise aggregation to work out the data of the bank groups viz. State Bank Group, 19 Nationalised Banks Group, Old Private Banks, New Private Banks and Foreign. Gross profit and net profit as percentage of total assets are major components of the tools of analysis.

The working results of State Bank Group during the post-reforms period from 1992-93 to 1996-97 are given the following table:

Working Results of State Bank Group :
Some important indicators 19

Particulars	1992-93	1993-94	1994-95	1995-96	1996-97 *(Rs. Crore)*
1. Operating Profit	2,264 (1.82)	2,035 (1.44)	2,583 (1.65)	3,912 (2.10)	4,457 (2.18)
2.. Net Profit	280 (0.22)	356 (0.25)	846 (0.54)	793 (0.42)	1,649 (0.81)
3. Income	13, 963 (11.21)	13,908 (9.87)	15,947 (10.20)	20,566 (11.02)	23,276 (11.39)
4. Interest Income	12,166 (9.77)	11,900 (8.45)	13,862 (8.87)	17,114 (9.17)	19,923 (9.75)
5. Other Income	1,797 (1.44)	2,007 (1.42)	2,085 (1.33)	3,452 (1.85)	3,354 (1.64)
6. Expenditure	13,683 (10.98)	13,552 (9.62)	15,101 (9.66)	19,773 (10.59)	21,626 (10.58)
7. Interest expended	8,416 (6.76)	8,119 (5.76)	8,751 (5.60)	10,871 (5.82)	12,819 (6.27)
8. Operating Expenses	3,283 (2.64)	3,753 (2.66)	4,613 (2.95)	5,782 (3.10)	5,999 (2.94)
9. Wage Bill	2,363 (1.90)	2,518 (1.79)	3,339 (2.14)	4,317 (2.31)	4,353 (2.13)
10. Provisions & Contingencies	1,984 (1.59)	1,679 (1.19)	1,736 (1.11)	3,119 (1.67)	2,807 (1.37)

Note: Figures in brackets are ratios to Total Assets

In order to make a comparative assessment, the working results of nationalised banks during the post-reforms phase are also given below:

Working Results of Nationalised banks : Some important indicators 20

Particulars	1992-93	1993-94	1994-95	1995-96	1996-97 (*Rs. Crore*)
1. Operating Profit	805 (0.38)	1,719 (0.72)	2,937 (1.04)	3623 (1.14)	4,439 (1.26)
2.. Net Profit	-3,648 (-1.72)	-4,705 (-1.98)	269 (0.10)	-1,160 -(0.36)	1,445 (0.41)
3. Income	22,126 (10.46)	23,390 (9.84)	26,999 (9.56)	33,074 (10.37)	37,994 (10.80)
4. Interest Income	19,945 (9.83)	20,554 (8.64)	23,984 (8.49)	29,418 (9.22)	33,987 (9.66)
5. Other Income	2,181 (1.03)	2,836 (1.19)	3,015 (1.07)	3,656 (1.15)	4,006 (1.14)
6. Expenditure	25,774 (12.18)	28,095 (11.82)	26,730 (9.46)	34,235 (10.73)	36,549 (10.39)
7. Interest expended	15,696 (7.42)	15,388 (6.47)	16,260 (5.76)	20,089 (6.30)	23,519 (6.68)
8. Operating Expenses	5,625 (2.66)	6,283 (2.64)	7,802 (2.76)	9,362 (2.93)	10,035 (2.85)
9. Wage Bill	3,916 (2.08)	4,276 (2.01)	4,668 (1.65)	6,828 (2.14)	7,278 (2.07)
10. Provisions & Contingencies	4,453 (2.10)	6,424 (2.70)	2,668 (0.94)	4,784 (1.50)	2,994 (0.85)

(Figures in brackets are ratios to total assets)

State Bank Group

In case of State Bank Group, there was a decline in interest income in 1993-94 mainly due to implementation of Income Recognition and Assets Classification norms and consequently ratio of interest

SOURCES:

19 & 20. Report on Trend and Progress of Banking in India 1995-96 (July - June) and 1996-97 (July - June), Reserve Bank Of India

income to total assets declined from 9.77% in 1992-93 to 8.45% in 1993-94. Impact of changes in interest rates on deposits and advances have been examined subsequently in the Chapter. Ratio of non-interest income to total assets also declined from 1.44% to 1.42 % during the relevant period due to lesser increase in non-fund based business. It had an impact on operating profit of the Bank Group, which declined from Rs. 2,264 crore to Rs. 2,035 crore. Even then net profit improved from Rs. 280 crore to Rs. 356 crore during the corresponding period due to a decrease in the provisions and contingencies from Rs. Rs1,984 crore to Rs. 1,679 crore during the corresponding period. Reduction in CRR, increase in income from Government securities due to increase in yields on treasury bills and Government dated securities also had a positive impact on bank profits. These rates have, however, declined in 1996-97. The working results of SBG have generally shown healthy trend of growth except 1996-97 when non-interest income declined from Rs. 3,452 crore in 1995-96 to Rs. 3,354 crore in 1996-97 due to a fall in the nonfund based business booked by them. The increase in wage bill during 1995-96 was due to wage revision at industry level during 1995. When compared with the working results of nationalised banks, State Bank Group performed much better and it earned net profits all along during the post-reforms period, whereas nationalised banks wre in red during 1992-93, 1993-94 ans 1995-96.

Nationalised Banks

The financial results of 19 Nationalised Banks showed a deterioration during 1992-93, 1993-94 and 1995-96 when they incurred net loss. This was mainly due to income recognition and assets classification norms prescribed for banks. NPAs depressed their interest income, which as percentage to total assets declined from 9.83% in 1992-93 to 8.49% in 1994-95. NPAs also increased the provisions and contingencies from 2.10% of the assets in 1992-93 to 2.70% in 1992-93. Wage bill increased from 1.65% of their total assets in 1994-95 to 2.14% in 1995-96 due to wage revision at industry level. Their performance improved during 1996-97 and they made net profit of Rs. 1,445 crore in 1996-97 as against net loss of Rs. -1,160 crore in 1995-96 because the impact of reforms measures like IRAC norms and requirements of provisions and contingencies stabilised. Net Profit as a ratio to total assets improved from a negative of -1.72% in 1992-93 to 0.41% in 1996-97. Other reasons for profits of the banks has been the reduction in cash reserve ratio (CRR), increase in income from Government securities due to increase in yields on treasury bills and Government dated securities. Increase in other income i.e. non-interest income in absolute terms has been due to exchange earned on remittances i.e. drafts and other remittance instruments, profit on sale of investments and other miscellaneous income.

In order to make further analysis of the comparative working results of different bank groups in India during the last 2 years, the comparative position of working results ratio to total assets in respect of pubilc sector banks, private sector banks (old as well as new) and foreign banks is given in the following table: 21

SOURCES:

21. Report on Trend and Progress of Banking in India 1995-96 (July - June) and 1996-97 (July - June) , Reserve Bank Of India

Working Results of banks in India: Comparative Position 21
1995-96 and 1996-97 Ratios to Total Assets

Particulars	Public Sector Banks 1995-96	Public Sector Banks 1996-97	25 Old Private Banks 1995-96	25 Old Private Banks 1996-97	9 New Private Banks 1995-96	9 New Private Banks 1996-97	Foreign Banks 1995-96	Foreign Banks 1996-97
1.Operating Profit	1.49	1.60	2.10	1.93	2.77	3.01	3.35	3.58
2.Net Profit	-0.07	0.56	1.06	0.92	1.85	1.77	1.58	1.41
3.Income	10.61	11.01	11.71	12.15	11.08	12.29	12.83	13.57
4.Interest Income	9.20	9.69	10.15	10.67	9.25	10.26	10.46	11.07
5.Other Income	1.41	1.32	1.56	1.48	1.82	2.02	2.37	2.50
6.Expenditure	10.68	10.46	10.65	11.23	9.23	10.51	11.25	12.17
7. Interest Expended	6.12	6.53	7.01	7.72	6.41	7.35	6.72	6.99
8.Operating Expenses	2.99	2.88	2.60	2.50	1.89	1.92	2.77	3.01
9.Wage Bill	2.20	2.09	1.70	1.51	0.27	0.30	0.98	1.06
10.Provisions & Contingencies	1.56	1.04	1.04	1.01	0.92	1.23	1.77	2.17
11. Interest Spread	3.08	3.16	3.14	2.96	2.84	2.91	3.74	4.09

It is, no doubt, true that old private banks, new private banks and foreign banks had higher net profit ratio to total assets as compared to public sector banks because of their low non-performing assets, higher ratio of non-interest income, lower operating expenses (with the exception of foreign banks) and lower wage bill. But there is a heartening feature that net profit to total assets ratio of public sector banks improved during 1996-97 (due to increase in their interest income ratio, decrease in expenditure ratio and lower provisions and contingencies ratio) despite a decline in all other category of banks as compared to the ratio of the previous year. The foreign banks have a much better total income to total assets ratio 13.57% in 1996-97 due to their higher earning assets but at the same time ratio of expenditure to total assets is also highest 12.17% 22 due to higher intermediation cost and interest expended ratio. Higher interest spread and lower wage bill put foreign banks in the top slot.

4.8.2 IMPACT OF INTEREST RATES

The interest rates on deposits for 1 to 3 years increased from 10% in 1993-94 to 11% in 1994-95 and

SOURCES:

22. Reserve Bank Of India , Bulletin December 1997

further to 12% in 1995-96. Thereafter it came down to 10% in 1996-97. As inflation was under control, minimum lending rate was reduced from 16% on June 24, 1993 to 15% from September 2, 1993 and further to 14% from March 1 ,1994. From October 18, 1994 minimum lending rate for credit limit of Rs. 2 lac was abolished and banks were free to fix their own prime lending rates. PLRs of Public Sector Banks ranging from 14.5% to 15.5% in October / November 1996 also registered a decline ranging from 13.5% to 14.5% in September 1997. The impact of the above changes in the rate of interest have been examined below. The following tables show interest income as percentage to total assets and interest expense as percentage to total assets for different group of banks :

Interest Income as % to total assets : Comparative Position of Bank Groups 23

Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
State Bank Group	10.20	9.77	8.45	8.85	9.17	9.75
19 Nationalised Banks	10.17	9.83	8.64	8.49	9.22	9.66
25 Old Private Sector Banks	9.72	9.39	8.91	8.89	10.15	10.67
9 New Private Sector Banks	--	--	--	2.33	9.25	10.26
Foreign Banks	11.61	11.62	10.04	9.88	10.46	11.07
100 Sch. Com. Banks	10.27	9.71	8.70	8.63	9.36	9.88

Interest income as percentage to total assets initially declined during 1992-93 and 1993-94 for all the category of banks (except foreign banks in 1992-93) and in 1994-95 as well (except for SBG) basically due to decrease in rate of interest on advances and also due to exclusion of interest income on non-performing assets on accrual basis. Foreign banks have the highest ratio of interest income followed by old private and new private banks and next being State Bank Group in 1996-97. The main reasons are that foreign banks on an average handle bigger loan accounts as compared to public sector banks, which attract higher rate of interest and their NPA level is much lower.

The interest expense to total assets had a mixed trend for all category of banks as would be observed

SOURCES:

23. Same as for item No. 22

from the following table:

Interest Expense as percentage to total assets 24

Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
State Bank Group	6.41	6.75	5.76	5.59	5.82	6.27
19 Nationalised Banks	7.31	7.40	6.46	5.75	6.30	6.68
25 Old Private Sector Banks	5.70	6.48	5.94	5.86	7.01	7.72
9 New Private Sector Banks	--	--	--	1.17	2.84	2.91
Foreign Banks	7.70	8.06	5.82	5.63	6.72	6.99
100 Sch. Com. Banks	6.96	7.20	6.16	5.63	6.23	6.67

Interest Expense as percentage to total assets also had a mixed trend. State Bank Group has lower interest expense ratio as compared to nationalised banks because of larger proportion of low cost deposits with them. Interest expense ratio is also higher for foreign banks on account of high cost deposits. During 1996-97 interest expense as percentage to total assets has increased for all category of banks despite a general tendency of fall in rate of interest. This is due to a general increasing proportion of time deposits to total deposits. As interest rates on deposits have been deregulated, banks have to exercise caution while fixing interest rates so that these do not turn adverse.

The position of interest spread in respect of different bank groups as percentage to their total assets in the post-reforms phase is given in the following table:

Name of the Bank Group	Net Interest Income (Interest Spread) as % to total assets 25					
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
State Bank Group	3.80	3.01	2.68	3.26	3.34	3.48
19 Nationalised Banks	2.86	2.02	2.17	2.73	2.92	2.97
Total Public Sector Banks	3.22	2.39	2.36	2.92	3.08	3.16
25 Old Public Sector Banks	4.02	2.91	2.97	3.04	3.14	2.96
9 New Private Banks	--	--	--	1.17	2.84	2.91
34 Private Banks	4.02	2.91	2.97	2.69	3.08	2.94
39 foreign Banks in India	3.92	3.56	4.21	4.24	3.74	4.09
100 Sch. Com. Banks	3.31	2.51	2.54	3.00	3.13	3.22

The decrease in interest spread in the post-reforms phase during 1992-93 are threefold : (a) lower CD ratio

SOURCES:

24 & 25. Report on Trend and Progress of Banking in India 1995-96 (July - June) and 1996-97 (July - June), Reserve Bank Of India

specially for public sector banks, (b) increased NPAs where income is not booked on accrual basis has also reduced interest income and (c) interest paid on deposits has increased due to preference for time deposits, which earn higher rate of interest. The highest ratio of net profit to total assets in respect of foreign banks makes them most viable as compared to other groups. State Bank group have been the second best in this regard in 1996-97 and it gives them a good lead to increase profits. However, with growing competition, banks will have to reconcile with finer interest spread and will have to explore avenues for non-interest income to increase their profits.

The following table gives Intermediation cost as percentage to total assets in respect of different bank groups:

Name of the Bank Group	Intermediation Cost as percentage to Total Assets 26					
	1991-92	1992-93	1993-94	1994-95	1995-6	1996-97
State Bank Group	2.48	2.63	2.66	2.95	3.10	2.94
19 Nationalised Banks	2.69	2.63	2.64	2.76	2.93	2.85
Total Public Sector Banks	2.61	2.63	2.65	2.83	2.99	2.88
25 Old Private Banks	2.98	2.72	2.45	2.33	2.60	2.50
9 New Private Banks	--	--	--	0.65	1.89	1.92
34 Private Banks	2.98	2.72	2.45	2.01	2.46	2.35
39 Foreign Banks in India	2.26	2.70	2.66	2.73	2.77	3.01
100 Sch. Com. Banks	2.60	2.64	2.64	2.76	2.94	2.85

Intermediation cost is defined as 'other operating expenses' excluding interest expenses and provisions and contingencies. It varies across the bank groups. The intermediation cost as percentage to total assets was lowest for the 9 new private sector banks and was highest for foreign banks in 1996-97. While small network is the advantage of new private sector banks, foreign banks have non-labour component i.e. ambitious computerisation as the highest constituent factor in intermediation cost. In case of public sector banks, wages constitute the bulk of intermediation cost. The wage bill ratio, as indicated in table no. 21, in case of public sector banks is double of foreign banks. Moreover, maintenance of advances to priority sector and other small advances and large number of rural branches require more of staff for handling them and these are also the causes for higher intermediation cost for the public sector banks.

SOURCES:

26. Same as source of item no. 24

The comparative postion of gross profit and net profit respectively of the different bank groups as ratio to their total assets is given in the following table

Gross Profit/Loss as % to Total Assets 27

Name of Banking Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
State Bank Group	2.75	1.82	1.44	1.95	2.10	2.18
19 Nationalised Banks	1.27	0.42	0.72	1.12	1.14	1.26
27 Public Sector Banks	1.84	0.94	0.99	1.41	1.49	1.60
25 Old Private Banks	2.08	1.36	1.82	2.16	2.10	1.93
9 New Private Banks	--	--	--	1.07	2.77	3.01
34 Indian Private Banks	2.08	1.36	1.82	1.96	2.23	2.22
39 Foreign Banks	5.06	1.86	3.79	3.93	3.35	3.58
100 Scheduled Com. Banks	2.08	1.03	1.25	1.64	1.69	1.82

Name of the Bank Group	Net Profit/Loss as percentage to total assets 28					
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
State Bank Group	0.21	0.22	0.25	0.54	0.42	0.81
19 Nationalised Banks	0.30	-1.71	-1.98	0.10	-0.36	0.41
Total Public Sector Banks	0.28	-0.99	-1.15	0.25	-0.07	0.56
25 Old Private Sector Banks	0.57	0.34	0.56	1.16	1.06	0.92
9 New Private Banks	--	--	--	0.64	1.85	1.77
34 Private Sector Banks	0.57	0.34	0.56	1.06	1.21	1.15
39 Foreign Banks in India	1.57	-2.88	1.51	1.66	1.58	1.41
100 Sch. com. Banks	0.39	-1.08	-0.85	0.41	0.16	0.68

Gross profits as percentage of total assets of all the categories of banks considerably declined during 1992-93 mainly due to application of IRAC norms. In case of public sector banks, the decline in profit during 1992-93 and 1993-94 was also caused to some extent by decline in CD ratio from 61.19% in 1991-92 to 48.41% in 1993-94. Thereafter, performance of all categories of banks improved after stabilisation of the impact of reforms measures. Foreign banks had the highest gross profit ratio followed by new private banks in 1996-97. State Bank Group performed better than 19 nationalised banks for two reasons : State Bank Of India has been the lead performer and its Associate Banks have also performed well whereas the performance of a few banks has been poor in the nationalised banks group.

After implementation of financial sector reforms, 1992-93 was the worst period for the nationalised

SOURCES:

27 & 28.Report on Trend and Progress of Banking in India 1995-96 (July - June) and 1996-97 (July - June), Reserve Bank Of India

banks and also for foreign banks as their net profit/loss to total assets turned negative mainly due to provisioning requirements under IRAC norms. For 19 nationalised banks, due to certain weak banks, implementation of IRAC norms and low credit-deposit ratio resulted in the negative overall performance i.e. net loss during 1992-93, 1993-94 and 1995-96. There was a turnaround in 1996-97 when 19 nationalised banks as a group earned net profits. Performance of State Bank Group also consistently improved with its net profit as percentage to total assets ratio increasing from 0.21% in 1991-92 to 0.81% in 1996-97.

The cost and rate of return parameters reflected by cost of deposits, return on loans, return on investments and ratio of interest income as well as interest cost and interest spread to total assets in respect of commercial banks are given below to examine the impact of various measures adopted in the light of banking sector reforms :

Return on Assets / Interest expended of Scheduled Commercial Banks in India 29

Year	Cost of deposits %	Return on loans %	Return on Investments %	Interest Income/ Total Assets Ratio	Interest Expended/ Total Assets Ratio	Net Interest Income/ Total Assets Ratio
1951	0.9	4.5	2.6	2.9	0.8	2.1
1960	2.1	5.5	3.4	3.6	1.7	1.9
1970	3.4	7.2	3.5	5.4	2.7	2.7
1975	5.2	11.9	4.7	7.5	4.3	3.2
1980	5.7	11.4	4.5	7.0	4.8	2.2
1985	6.1	12.1	3.7	7.0	4.5	2.5
1989	8.0	12.8	4.2	9.0	6.1	2.9
1995	6.3	10.5	10.9	8.7	5.6	3.1
1996	6.9	12.3	11.2	9.4	6.2	3.2
1997	7.5 *	13.7 *	10.6 *	9.9	6.7	3.2

* Worked out on the basis of data given in Performance Highlights of banks 1996-97, Indian Banks' Association Bombay and RBI Bulletin December 1997 Note: (i) Return on loans = Earnings on loans / total loans (ii) Return on Investment /Total Investments
Data upto 1989 is ending December and data from 1995 to 1997 is ending March

We observe that, in the pre-reforms phase, cost of deposits and return on advances continued to increase significantly upto 1975. Thereafter, return on loans decreased during 1975-80 whereas cost of

SOURCES:

29. RBI Occasional Papers, Vol. 18 Nos. 2 & 3 June & September 1997, Page 329 all data except those marked * worked out from the data contained in Performance Highlights of Banks, 1996-97, IBA Bulletin and those marked @ taken from RBI Bulletin , December 1997

deposits increased and from there started problem of viability of banks. The differential between the two rates improved to 6.2% in 1997 as compared to 4.8% in 1989. Moreover, return on investment also improved significantly during the post-reforms period due to higher return on Government securities. These factors have contributed to increased profits of scheduled commercial banks in the post-reforms phase.

The credit deposit ratio is another factor having a bearing on the profitability of the banks. The table containing CD ratio of different group of banks in the post-reforms phase is given below:

CD Ratio of commercial banks : Comparative position 30

Name of the Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Total Public Sec. Bks.	61.19	58.47	48.41	50.95	53.10	49.02
Old Private Banks	52.45	51.81	48.83	52.90	57.79	54.88
New Private Banks	--	--	--	--	82.33	59.67
Foreign Banks	54.42	49.98	44.32	54.84	73.68	71.57

Thus credit-deposit ratio of public sector banks has considerably declined in the post reforms period. It may be a natural phenomena partly due to the reason that after implementation of prudential norms including income recognition and assets classification criteria , banks tend to become over-cautious. In 1996-97 the CD ratio of all the category of banks has declined due to sluggish offtake of commercial bank credit as industrial growth has taken place at slow pace. Even the new private banks, which had achieved a high CD ratio of 82.33 in 1995-96 slumped to 59.67 in 1996-97. The CD ratio of foreign banks also declined from 73.68% in 1995-96 to 71.57% in 1996-97 and main reason has been deceleration of industrial growth in India. As loaning is the core of the banking activity and most profitable of all its operations, banks will have to accept the challenge and increase the CD ratio, of course, without involving themselves in the 'adverse selection process .'

Profitability and productivity are interrelated and both represent organisational effectiveness in terms of utilisation of resources. The measurement of productivity is difficult in a service industry like banks, where output is not in physical terms. One aspect of measuring productivity is in terms of business per employee by aggregating total deposits and advances. By disaggregating the above variables, advances per employee and deposits per employee can also be worked out and that gives a better and more specific position. Net profit per employee is also a method of evaluating the performance of employees in the banks. These indicators are given below in the following table giving bankwise position in the post-reforms period :

SOURCES:

30. Bulletin No. XIX, No. 3 , March 1997 and Performance Highlights of Banks 1996-97 of Indian Banks Association, Mumbai

Productivity Indicators of banks in India 31

(Amount in Rs. Lakh)

Name of the bank Group	Advances Per-employee		Deposits per employee		Net Profit per-employee	
	1991-92	1996-97	1991-92	1996-97	1991-92	1996-97
State Bank Group	16	26	23	46	0.08	0.52
19 Nationalised Banks	16	24	28	52	0.10	0.25
25 Old Private Banks	12	35	23	64	0.15	0.70
9 New Private Banks	--	318	--	532	--	11.62
Foreign Banks	70	192	129	268	2.94	5.66

Thus advances per employee and deposits per employee were highest in respect of foreign banks in 1991-92. But in 1996-97 new private sector Indian banks topped the list because of their smaller set up and their thrust on large business and profitability. Public sector banks comprising of State Bank Group and Nationalised Banks have to meet their commitment for mass banking and rural sector lending and as such productivity ratios in their case are lower than the aforesaid foreign and new private banks but PSB productivity ratios are showing an improving trend. As regards net profit per employee for all the group of banks, it has improved with improved profitability. It is highest for new private banks followed by foreign banks. The reason is their small structure and lesser socio-economic obligations.

Other indicators of profitability are Return on Assets (ROA) and Assets Utilisation Factor (ARF). The following table shows ROA and ARF of different group of banks in India during 1991-92 and 1996-97 so as to assess the progress in the post-reforms phase :

	Return on Assets (ROA)		Assets Utilisation Factor (AUF)	
Name of the Bank	1991-92	1996-97	1991-92	1996-97 32
State Bank Group	0.24	0.81	11.21	11.39
19 Nationalised Banks	0.33	0.41	10.64	10.80
Public Sector Banks	0.28	0.56	10.86	11. 01
Old Private Banks	0.57	0.92	10.16	12.15
New Private Banks	--	1.77	--	12.29
Foreign Banks	1.59	1.41	14.40	13.57

Thus return on assets (Net Profit multiplied by 100 and divided by total assets) and assets utilisation factor (Total Income multiplied by hundred and divided by total assets) have improved in respect of all the

SOURCES:

31 & 32. Self calculated on the basis of data furnished in Performance Highlights of Banks 1996-97 and Bulletin No. XIX, No. 3, March 1997 of IBA

group of banks (except for foreign banks because of their intermediation cost) in the post reforms phase due to increase in their net profit and total income as compared to their assets. The improvement in these ratios is a healthy sign. New private banks and foreign banks having smaller establishment and main thrust on profits have better ROA and AUF than public sector banks.

A. Non - Performing Assets

All commercial ventures earn part of their income by risk-taking. Banks are also placed in a similar position and being a financial institution, the element of risk is higher. But this risk has to be managed effectively. They have to save themselves from 'adverse selection problems.' A balance has to be struck between risk and yield. But the problem in India also arises out of directed lending and social banking where the small beneficiaries are not able to generate adequate surplus to repay the banks' dues. Other reasons for mounting NPAs have been inadequate attention to qualitative aspects of lending in a bid to achieve the targets and dispensing with the requirement of margin on stocks and collateral securities. For a long time, Indian banks have treated sticky assets as Non-Performing Assets. The concept of 'accrued interest' has been prevalent but due attention was not paid to the main issue whether interest has been realised. This is the essence of definition of NPAs of Narasimham Committee. An asset which ceases to earn income for the bank should be treated as NPA, and any income from NPA should not be booked unless it is actually recovered. As per Income Recognition and Assets Classification (IRAC) Norms, a credit facility will have to be treated as Non-Performing Asset (NPA) if interest or instalment of principal has remained unpaid for a period of two quarters or more during the year. While detailed analysis of NPAs as per the Report of the Narasimham Committee have been analysed in depth in the previous Chapter, it is necessary to pinpoint that NPAs erode income and contaminate assets.

In this connection, it is necessary to make distinction between gross and net NPAs of banks. Net NPA is derived from gross NPA by excluding (a) balance in interest suspense account i.e. interest due but not received, (b) DICGC / ECGC claim received and kept in suspense account pending adjustment (for final settlement), (c) part payment received and kept in suspense account and (d) total provisions held. Net NPA is internationally recognised as relevant. The comparative position of non-performing assets of different group of banks is given in the following table:

Net Non-Performing Assets of Banks : Comparative Position: 33

Name of the Bank	1995-96 Net NPAs Rs. crore	1995-96 % of Net NPAs to net Advances	1996-97 Net NPAs Rs. crore	% of Net NPAs to Net Advances
State Bank Group	5,362.02	6.88	6,382.01	7.70
19 Nationalised Banks	12,935.47	10.14	13,902. 72	10.07
25 Old Private Banks	793.46	4.51	1,245.28	5.99
9 New Private Banks	--	--	161.41	2.07
39 Foreign Banks	182.91	0.81	670.63	2.50

It is observed from the above table that the percentage of net NPAs to net advances has deteriorated in 1996-97 over the previous year in respect of all the category of banks (except nationalised banks). State Bank Net NPAs ratio at 7.70% in 1996-97 is better than nationalised banks whose ratio is 10.07% but adverse feature for SBI is increase in their net NPA from 6.68% of their net credit to 7.70% in 1996-97. A good feature in respect of nationalised banks is that net NPA as percentage to net credit declined from 10.14% in 1995-96 to 10.07% in 1996-97. New private banks had the lowest net NPA to total assets being 2.07% followed by 2.50% in case of foreign banks.

Out of 27 public sector banks, 10 banks had net NPAs above 20% in March 1995 but with vigorous efforts the number has gone down to one in March 1997. 2 foreign banks also had net NPAs of more than 20% in 1996-97. Out of 100 scheduled commercial banks 85 banks had net NPAs upto 10% of their net credit in 1996-97

All the banks will have to bring about substantial improvement in this regard. Non-performing assets are neither productive nor active assets. The funds blocked in these assets are not cycled for productive purposes. Banks, therefore, have designed strategies for improving the recovery position and reducing NPAs, which include suitable follow-up action including recovery/ nursing/ compromise / legal recourse. The quality of appraisal plays an important role. Banks should observe sound lending principles and should enforce lending discipline by the borrowers by close follow-up action. Timely and adequate credit are essential; subject , of course, to techno-economic feasibility of the project and completion of required formalities. Under-financing and over-financing both are harmful. Banks have, therefore, to play an expert role. Credit-worthiness of the borrowers has also to be examined from the market report and also important financial ratios have to be examined from the financial statements. Constant follow-up and inspections are essential for ensuring proper end-use of funds and future developments. Suitable statements may be designed for large advances called 'Monthly Select Operational Data' (MSOD) statements. The information system will throw light on Early Warning Signals (EWS) in regard to financial and operational affairs of the borrowers.

Some banks have opened recovery branches. In order to improve the climate for recovery, recommendation of Narasimham Committee for setting up of Recovery Tribunals for banks and financial institutions was accepted. With setting up of these tribunals, it is hoped that banks will be able to quickly recover their overdues.

(B) *Capital adequacy Ratio :*

Capital Adequacy Ratio (CAR) of public sector banks improved from 8.7% in 1995-96 to 10.0% in 1996-97. Out of the 27 public sector banks 25 banks (19 banks last year), have attained the stipulated 8% capital adequacy requirement. During 1996-97, 16 banks had CRAR exceeding 10% (6 banks last year),

SOURCES:

33. Report on Trend and Progress of Banking in India 1996-97 (July-June) , Reserve Bank Of India

while in case of 9 banks CRAR ranged between 8% to 10%. The general improvement in CRAR in case of PSBs has been facilitated to a great extent by their recapitalisation by the Government and some of the public sector banks accessing the capital market.

All Indian private sector banks (except four old private sector banks) and all foreign banks have achieved the minimum capital adequacy ratio of 8%.

4.9 SOME IMPORTANT MODELS DEVELOPED FOR EVALUATION OF PERFORMANCE OF BANKS

Banking sector, being a multi-product service industry, its performance evaluation involves identifying indicators reflecting its multi-faceted dimensions. Productivity in banks is normally measured as per employee business, where business is taken as the total of deposits and advances. With the change in the market scenario there is a need to go in for more comprehensive way of measuring the efficiency rate. The Model developed by Dr. Satyanarayana 34 takes into account network of branches, number of staff, wage and non-wage operating expenses representing the input factors. Deposits, advances, non deposit working funds, interest spread, non-interest income and net profit are considered to constitute the basket of output. Market share concept is adopted to eliminate the limitations of comparing the banks of different size. An application of the above model during 1969-94 indicated an average efficiency level of 181% for foreign banks, 103% for State Bank Of India, 79% for Associate Banks of State Bank Of India, 82% for Nationalised Banks and only 74% for Indian Private Banks. The class banking character of the foreign banks perhaps enabled them to utilise their input factors very efficiently when compared to domestic banks. Private sector Indian banks, though consistently profitable, left a lot of scope in utilisation of their input factors.

In another model developed by Sri Kaveri 35 & others for branch performance, they have evolved a scoring system. The model consists of nine broad areas concerning performance of branches. These include (I) deposit mobilisation , (ii) loans and advances (iii) recovery, (iv) Productivity and profitability, (v) customer and ancillary services, (vi) staff matter, (vii) house keeping, (viii) bank marketing and (ix) general. The total marks earmarked for these nine performance areas are 100. Marks are not allotted on uniform basis. In order of importance of these performance areas, marks vary from one to another. Deposit mobilisation areas comprise of achievement of deposit target, growth in deposits and reduction in cost of deposits. Loans and advances comprise of achievement of advances targets, fulfillment of social obligations and growth in advances. Non-Performing Advances to total advances and recovery performance

SOURCES:

34. " Productivity Beyond Per Employee Business", Dr. Satyanarayana K., Faculty Member National Institute of Bank Management, Pune, Indian Banks' Association Bulletin 1996

35. " Branch Performance and Scoring Model ", Kaveri V.S., Swarup K., Shete N.B. of National Institute of Bank Management, Vinimaya , NIBM, Pune Vol. XVI No.1 , 1995-96

decide the scoring of Recovery Parameter. Productivity and profitability have two areas : business per employee and ratio of net profit to total income. Similarly, other parameters have indicators for scoring. The Scoring Model provides an indication of improvement or deterioration in the overall health of the branch. This sets the beginning for making a study of the branch. The suggested model also helps the manager to retain and boost the areas of strength of the branch and remove the deficiencies. It is also a flexible model and, if necessary, changes may be introduced in the allotment of marks and / or the indicators.

4.10 CONCLUSION

Thus the concept of profit has been a matter of intense debate and keen interest among economists, financial experts, policy makers and commercial banks. A few elements of profit, enunciated by economists long ago, have considerable relevance even today. It is a reward for risk-taking, which has increased manifold in the modern complex financial sector. The concept of innovations is more relevant today than ever before due to growing application of computers and information technology. Finally, profit is a cause and effect of business dynamics leading to efficient allocation of resources, which are scarce but have alternate uses. The concept of speculative profit is beyond our purview.

Banks are commercial organisations and their performance has to be economically viable. After nationalisation, thrust was on geographical and functional coverage by banks with social orientation. In the process, the profitability of banks was lost sight of. Several exogenous and endogenous factors have been responsible for this problem. We have examined the causes through "Backward Linkages Procedure." Under this procedure, the primary factors, secondary factors, tertiary factors and fourth associate factors are identified. We have added to these groups, supplementary factors like competition by other financial intermediaries viz. non-banking financial companies and developmental financial institutions. With the process of disintermediation and introduction of commercial paper, the position has become more competitive and fluid.

After receipt of Narasimham Committee recommendations, in November 1991, Reserve Bank Of India initiated several reform measures from 1992-93 and onwards. Statutory Liquidity Ratio was reduced to 25% in phases and Cash Reserve Ratio is 11%. These reductions have increased lendable resources of banks. Rate of interest on Government is near market-related and it has added to income of banks. Interest rates have been deregulated to a great extent. Area of priority sector lendings has been enlarged to some extent. These factors have great positive impact on the profitability of banks.

Prudential norms were also introduced in the form of income recognition, assets classification and capital adequacy requirements. Specific criteria for non-performing assets has been laid down. IRAC norms serve a useful purpose of setting in train the process of cleaning the balance sheet. Initially there was compression in interest income of banks as interest on accrual basis is not allowed as income in respect of non-performing assets. Banks also had to make large provisions and contingencies. It had a great strain on their capital base. By recapitalisation by the Government and accessing the capital market by a few banks,

CAR of 8% has been achieved by 25 out of 27 public sector banks. All new private sector banks and foreign banks have achieved the aforesaid CAR. Only four out of 25 old private banks have to achieve the above CAR target.

With the above pressure of cleaning the balance sheet being over, the performance of all categories of banks has started looking up. The net interest income as percentage of total assets of scheduled commercial banks increased from 2.51% in 1992-93 to 3.22% in 1996-97. Their gross profit to total assets improved from 1.03% to 1.82% during the aforesaid period. The net profit to total assets of SCBs improved from a negative of -1.08% to 0.68% during the relevant period. Consequently return on assets, return on equity and productivity ratios like business per employee and profit employee have generally improved for all category of banks. This is a great achievement for the banking sector.

But liberalisation, greater deregulation of interest rates, competition and globalisation have imposed greater responsibilities on banks. Banks will have to devise mechanism for determining deposit and lending interest rates and this will be a tight rope exercise because interest rate has to be remunerative and at the same time competitive. Competition from new private and foreign banks has to be met and at the same time, public sector banks, old private sector banks and other category of banks have to save themselves from ' adverse selection ' of borrowers. While globalisation provides access to low cost funds in the foreign markets, the exchange rate and other risks pertaining to foreign exchange markets have to be properly hedged. This is crucial keeping in view the recent Asian Currency Crisis.

We have seen in the foregoing paragraphs that non-performing assets have started increasing again in respect of some of the public sector banks. Net NPAs as percentage to net advances for State Bank Group increased from 6.88% in 1995-96 to 7.70% in 1996-97. For nationalised banks Net NPAs were already as high as 10.14% in 1995-96 and they marginally declined to 10.07% in 1996-97. For the public sector banks as a whole, NPAs increased from 8.90% to 9.18% during the aforesaid period. The aforesaid ratios are very high as compared to 5.99% for old private banks 2.07% for new private banks and 2.50% for foreign banks. The international standard is Net NPAs to Net Credit ratio of less than 5%. Public sector banks have to devise suitable strategies, both preventive and curative, to control NPAs so as to enhance profitability and achieve the international standard.

In the light of the aforesaid developments in the realm of growth and profitability of commercial banks, we shall analyse the performance of the selected three public sector banks in the next chapter.

CHAPTER V

STATE BANK OF INDIA : A PROFILE

5.1 Introduction

5.2 Important indicators of business growth

5.2.1 Branch network

5.2.2 Bank domestic deposits

5.2.2.1 Market share in total deposits

5.2.2.2 Composition of deposits

5.2.3 Bank credit

5.2.3.1 Market share in advances

5.2.3.2 Sectoral deployment of bank credit

(a) Industrial finance

(b) Priority sector lendings

* Advances to small scale industries

** Agricultural finance

*** Small business finance

**** Export finance

5.3 Operations of foreign offices of State Bank Of India
5.4 Credit Deposit Ratio

5.5 Treasury and investment management

5.6 Profit and Loss Account

(i) Total income

(ii) Total expenditure

(iii) Interest spread

5.7 Net profit

5.8 Financial ratios

5.9 Productivity Ratios

5.10 Non-performing assets (NPAs)

5.11 Prudential Standards

5.12 Risk Management

5.13 Capital adequacy ratio

5.14 Issue of Global Deposit Receipts

5.15 Issue of Resurgent India Bonds
5.16 Contingent Liabilities
5.17 Use of modern technology

5.18 Human Resources Development

5.19 Conclusion

CHAPTER V

STATE BANK OF INDIA : A PROFILE

5.1 INTRODUCTION

We have selected State Bank Of India, a public sector bank alongwith two other public sector banks for study of their growth and profitability from 1991 i.e. when financial sector reforms had their genesis in India. The reason for selecting State Bank Of India is that it is the largest commercial banks in India in almost all important facets of banking viz. network of branches, deposit-base, total assets, profits and human resources etc. On March 31, 1998, the Bank had total assets of Rs. 1,79,673 crore, total deposits of Rs. 1,31,091 crore, total advances (including bills) of Rs. 74,237 crore, investment (within India as well as outside India) of Rs. 54,982 crore, net profit of Rs. 1,861.20 crore with a network of 8,925 branches (out of which 52 branches are established abroad spread over 33 countries). 1 SBI, with such a strong profile, plays a very crucial role in the banking and financial sector in promoting economic development of India.

The history of State Bank Of India dates back to the establishment of Presidency Banks because they were merged into Imperial Bank Of India, which was later taken over by SBI. In 1809, Bank Of Bengal, a Presidency Bank, obtained its charter in India with a capital of Rs. 50 lakhs. In 1839, the bank was given power to open branches. The two other Presidency Banks, the Bank Of Bombay and the Bank of Madras were established in 1840 and 1843 respectively. The Presidency Banks were amalgamated into the Imperial Bank Of India, which came into existence on January 27, 1921 by the Imperial Bank Of India Act 1920. State Bank Of India came into existence on July 1, 1955 as per the recommendations of the All India Rural Credit Survey Committee, which stressed the need for " one strong, integrated, state sponsored, state partnered commercial banking institution with an effective machinery of branches spread all over the country." 2 The undertaking of Imperial Bank Of India was taken over by State Bank Of India in terms of State Bank Of India Act 1955.

In terms of the provisions of State Bank Of India (Subsidiary Banks Act) of 1959, the Bank Of Bikaner, the Bank Of Indore, the Bank Of Jaipur, The Bank Of Mysore, the Bank Of Patiala, the Travancore Bank, the State Bank Of Hyderabad and State Bank Of Saurashtra were constituted as banking subsidiaries of State Bank Of India and the following 7 subsidiaries came into existence:

(i) State Bank Of Bikaner and Jaipur
(ii) State Bank Of Indore
(iii) State Bank Of Mysore

SOURCES:

1. State Bank Of India , Annual Report 1997-98

2. All India Rural Credit Survey : Report of the Committee of the Direction, 1954 , Reserve Bank Of India

(iv) State Bank Of Patiala
(v) State Bank Of Travancore
(vi) State Bank Of Hyderabad
(vii) State Bank Of Saurashtra

In addition to the above Associate Banks, SBI has the following Banking and Non-Banking Subsidiaries in India : 3

(a) Name of the Banking subsidiary in India	Main Business
(I) SBI Commercial & International Bank Ltd. (SBICI)	Corporate and selective personal banking
(b) Name of the Non-Banking Subsidiaries / Affiliates in India	
(i) SBI Capital Markets Ltd. (SBICAP)	Merchant banking, leasing and hire purchase
(ii) SBI Funds Management Ltd. (SBIFML)	Mutual fiind
(iii) SBI Home Finance Ltd. (SBIHFL)	Housing Finance
(iv) SBI Factors & Commercial Services Pvt. Ltd. (SBI Factors)	Factoring Services
(v) SBI Gilts Ltd. (SBIGL)	Primary dealer in the Government securities Market

As we have identified State Bank Of India (alongwith two other public sector banks) to analyse its growth and profitability, we have used its data and not of the State Bank group in this Chapter. We have, however, used the data of its Associate Banks and other group of banks for purposes of comparison.

5.2 IMPORTANT INDICATORS OF BUSINESS GROWTH

We have examined below the important dimensions of business, growth and profitability of State Bank Of India in a comparative manner under various heads like branch network, deposits, advances and its sectoral spread viz. industrial finance, priority sector lendings , total income, total expenses, interest spread, net profit and important financial ratios.

5.2.1 *BRANCH NETWORK*

Branch network basically serves two important purposes : (a) it serves as a platform for delivery of

SOURCES:
3. State Bank Of India Annual Reports 1993-94 and 1997-98

services and (b) acts as a set up for expansion of business. A large network of branches (totaling 8836 as on 31.3.97)spread over the length and breadth of the country is one of the basic sources of strength for the SBI providing effective points for resource mobilisation and also easy outlets for its various products and services. Starting from a modest level of 466 branches in 1955, the tempo of branch expansion was very fast and as at the end of March 1981, the bank had 5971 branches in India; of which 78% branches were located in rural and semi-urban areas. The Bank fulfilled the objectives of Reserve Bank Of India's Branch Licensing Policy from time to time by opening branches in unbanked areas and also at rural and semi-urban centres. The total number of branches increased to 8,582 (in India) in March 1992, of which 6,585 branches accounting for 76.7% were located in rural and semi-urban areas.

The comparative position of branch expansion of State Bank Of India alongwith other bank-groups i.e. associates of SBI, nationalised banks (with separate data for Bank Of India and Oriental Bank Of Commerce selected for study), foreign banks, old and new private banks for the period 1991-92 and 1996-97 is given in the following table

Scheduled Commercial Banks branches in India *

Banks and Bank-Groupwise Distribution 4

Bank Group	31 st March 1992					31st March 1997				
	Rural	Semi-urban	Urban	Metro	Total	Rural	Semi-Urban	Urban	Metro	Total
1.State Bank of India	4,350 (50.7)	2,235 (26.0)	1,216 (14.2)	781 (9.1)	8,582 (100)	4,390 (49.7)	2,290 (25.9)	1,340 (15.2)	816 (9.2)	8,836 (100)
2. Associates of SBI	1,566 (37.1)	1,333 (31.6)	821 (19.5)	498 (11.8)	4,218 (100)	1,469 (34.8)	1,414 (33.5)	835 (19.7)	508 (12.0)	4,226 (100)
3.Nationali--sed Banks	14,358 (49.0)	5,700 (19.5)	5,224 (17.9)	3,990 (13.6)	29,272 (100)	14,223 (45.0)	6,542 (20.7)	6,015 (19.1)	4,787 (15.2)	31,567 (100)
of which										
(a) Bank Of India	1,293 (55.7)	387 (16.6)	362 (15.6)	281 (12.1)	2,323 (100)	1,251 (50.9)	431 (17.6)	386 (15.7)	388 (15.8)	2,456 (100)
(b) Oriental Bk.of Com.	249 (46.7)	94 (17.6)	113 (21.2)	77 (14.5)	533 (100)	246 (32.6)	228 (30.2)	185 (24.5)	96 (12.7)	755 (100)
4. Foreign Banks	-- --	1 (0.7)	16 (11.5)	122 (87.8)	139 (100)	-- --	-- --	30 (17.0)	146 (83.0)	176 (100)
5. Old Pvt. Banks	1,409 (37.0)	1,095 (28.8)	830 (21.9)	468 (12.3)	3,802 (100)	1,415 (32.7)	1,332 (30.7)	998 (23.0)	589 (13.6)	4,334 (100)
6. New Pvt. Banks	-- --	-- --	-- --	-- --	-- --	-- --	18 (14.0)	44 (34.9)	66 (51.1)	128 (100)
7. Total	21,683 (47.1)	10,364 (22.5)	8,107 (17.6)	5,859 (12.8)	46,013 (100)	21,497 (43.6)	11,596 (23.6)	9,262 (18.8)	6,912 (14.0)	49,267 (100)

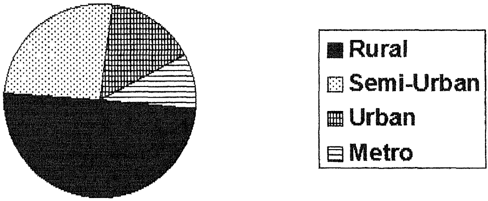
(* Excluding Regional Rural Banks and non-scheduled banks) Figures in bracket are percentage to total

The total number of scheduled commercial bank branches have increased by 7.1% during the period of 5 years in the post-reforms phase i.e. 1992-97 and SBI branches have increased by 2.9% over the same period. The branch expansion is slower in case of SBI because it already has the largest network of branches i.e. 8836 in 1996-97 and its main thrust has to be on consolidation. From the above table it is observed that larger expansion has taken place in Oriental Bank Of Commerce (41.6% expansion of branches during the above period) and about 14% in case of Old Private Banks. Rural branches as a percentage of total branches have, however, registered a decline for all the categories of scheduled commercial banks during the post-reforms period 5 because the guiding factor is economic viability of the branch. Foreign banks and new private banks have been allowed to open their branches in India and all the branches of foreign banks in 1996-97 were located in metropolitan (146 branches) and urban centres (30 branches) and new private banks too had concentration in such areas (66 in metros and 44 in urban centres) with 18 semi-urban branches. As regards rural and semi-urban branches taken together State Bank Of India had the highest percentage 75.6% of total branches in March 1997. The composition of branches of SBI is depicted by the following pie-chart:

State Bank Of India : Composition of Branches 1996-97

(Rural 49.7% , Semi-urban 25.9% , Urban 15.2% & Metro 9.2%)

Classification of branches



Pie Chart prepared on the basis of the table given on the previous page

SOURCES:

4. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97 , IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 and 1996-97.

5. The data of Regional Rural Banks (RRBs) is not included in the above table as it is not a scheduled commercial bank. However, in March 1997 out of 14,460 branches of RRBs, 12,424 branches (85.9% of total) were located in rural areas.

The above pie-chart shows the composition of branches of SBI and the largest share, almost half of the above circle (49.7%) comprises of rural branches followed seriatim by semi-urban, urban and metropolitan branches.

SBI has done a commendable job by opening branches at remote places like Leh and Drass in Ladakh, the coldest and remotest Regions in the north, Chazouba in Nagaland in North East, the Andman and Nicobar Islands and at many centres in the tribal belts of Madhya Pradesh and Orissa 6 despite absence of minimum basic facilities, moving the personnel to the inaccessible pockets and has made a useful contribution to the development of backward regions in the country. In order to cater to the needs of the customers, who do not find the normal banking hours convenient, the Bank has opened morning / evening branches in residential and/or commercial and other areas of urban and metropolitan centres.

Driven by its policy emphasis on meeting the banking requirements of specific customers group, the Bank has been opening specialised branches. The Bank started with the opening of Agricultural Development Branches (ADBs) to meet the needs of agricultural sector. Thereafter, the Bank has opened specialised branches for other segments like Industrial Finance Branch (IFB), Overseas Branch, SSI Branch and Personal Banking Branches etc. The Bank also has a global presence and the network of its foreign branches as on 31st March 1998 covered 52 offices spread over 33 countries.

In terms of Reserve Bank Of India guidelines, SBI had identified 220 branches for being developed as 'Model' branches. Additionally, a proper mix of branches out of the Bank's wide network of branches were to be picked up for being similarly developed. Factors like the layout, workflow, quality of advances, employee productivity, profitability and the quality of customer service rendered are considered while making the selection. 7 Improvement in the quality of service rendered at these branches is periodically reviewed.

In view of the increased number of branches and to exercise effective control, SBI introduced a Scheme of Reorganisation in 1971. Segmentation of accounts on the basis of market segments was done e.g. commercial and institutional, small industries and small business, agricultural banking, personal banking and international banking. A Review of the Bank's organisational structure was conducted in 1978 and the new Modular Structure was introduced in 1979 on an experimental basis in two Circles of the Bank. The new design entailed the location of operational decision centres nearer the area of operation by setting up Regional Offices at strategically important places leading to decentralisation. The Bank's business operations have been further reorganised under four strategic business groups : viz. Corporate Banking , National Banking , International Banking and Associates and Subsidiaries. As parts of Corporate Banking Group, three Strategic Business Units (SBUs) viz. Corporate Accounts, Leasing and Project Finance, set up under the new organisational structure of the Bank, are functioning with focused attention on top corporate customers. 8

SOURCES:

6. State Bank Of India, Annual Report 1979
7. State Bank Of India Annual Report 1992-93
8. State Bank Of India, Annual Report 1996-97

Thus with nationwide network of 8836 branches and 52 offices abroad as on March 31,1997, State Bank Of India has the largest branch network of bank branches in India. The Bank's domestic branches represent about 17.9% of scheduled commercial bank branches in India as at end-March 1997. The widespread branch network is a source of strength for the bank and provides a base for mobilising deposits, broadbased lending activities, remittance facilities and other financial services.

5.2.2 *BANK'S DOMESTIC DEPOSITS*

Deposits and advances are the traditional finctions of commercial banks. Bank deposits are the major building block as they provide the fund base for lending and other uses. Deposits represent the major item on the liabilities side of the bank's balance sheet. These are also one of the important indicators of business growth of commercial banks. State Bank has, therefore, laid emphasis on deposit mobilisation. The Bank apart from selling generic schemes also started marketing specific schemes tailored to meet the requirements of the different customer groups. In pursuance to this strategy, 3 new schemes viz. the Police Welfare Scheme, the Package for Pensioners Scheme and the State Bank Educational Plan were introduced in 1982. These are only a few examples and SBI has marketed several such schemes from time to time. The aggregate domestic deposits of SBI further increased to Rs. 43,583 crore in March 1991 i.e. more than trebled during a period of 9 years. The personal segment deposits of the bank, recorded a growth of 19.2% during 1990-91 and as such the share of this segment to aggregate deposits which was 51.1% as at the end of March 1990 increased to 52.5% as at the end of March 1991.

SBI domestic deposits, which had crossed Rs. 50,000 crore mark (Rs. 53,664 crore) in 1991-92, increased to Rs. 60,414 crore in 1992-93 (12.6% growth), to Rs. 68,378 crore in 1993-94 (13.2% growth), to Rs. 80,302 crore in 1994-95 (17.4% growth), to Rs. 90,145 crore in 1995-96 (12.3% growth) and crossed another milestone during 1996-97 with its domestic deposits exceeding Rs. 1,00,000 crore mark . In 1996-97 domestic deposits of SBI amounted to Rs. 1,03,767 crore (15.1% growth over the previous year). 9 Thus deposit growth of SBI has been consistent but due to its high deposit base, its average annual growth of deposits during 1991-92 to 1996-97 i.e. 18.7% (computed with the base year of 1991-92), is lower as compared to average annual growth of deposits of some other banks / bank groups : Oriental Bank Of Comerce 35.9%, foreign banks 24.3%, new private banks 120.5%, total scheduled commercial banks 23.3%. The growth rate is, however, better than Bank Of India.

The data from 1991-92 to 1996-97 in respect of domestic deposits of State Bank Of India, other two selected public sector banks i.e. Bank Of India and Oriental Bank Of Commerce and other Bank Groups are

SOURCES:

9. State Bank Of India, Annual Report 1991-92 to 1996-97

given in the following table so as to give a comparative position of progress in mobilisation of deposits.

Domestic Deposits : Bank-Groupwise Comparative position

(Amount Rs. in crore) 10

Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	Average% increase 1991-92 to 1992-97
State Bank Of India	53,664	60,414	68,378	80,302	90,145	1,03,767	18.7
Associate Banks	14,834	17,728	21,472	27,328	31,534	37,192	30.1
19Nationalised Banks	1,40,088	1,57,106	1,89,338	2,24,938	2,45,494	2,76,632	20.8
Old Private Banks	12,082	15,231	19,984	26,257	30,077	37,522	42.1
New Private Banks	--	--	--	--	5,937	13,092	120.5
Foreign Banks	16,898	20,875	25,897	28,034	30,632	37,394	24.3
Total Sch. Com. Banks	2,37,566	2,71,354	3,25,069	3,86,859	4,33,819	5,05,599	23.3
Bank Of India	13,074	14,553	16,294	18,904	21,614	24,934	18.1
Oriental Bank Of Commerce	3,599	4,277	5,239	6,673	8,711	10,054	35.9

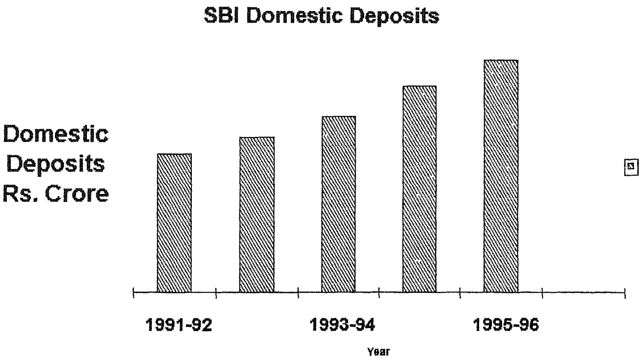
The growth in SBI deposits was contributed to a large extent by personal segment deposits and their share increased from 52.5% in March 1991 to 56.5% in 1996-97. This is a less volatile source of funds and imparts stability to the resource base. Credit goes to product innovation and marketing techniques of the Bank. A unique net retail banking product launched by SBI during 1993-94 was the liquid term deposit scheme introduced at selected branches, which provides the facility of partial withdrawals in specified units against

SOURCES:

10. Indian Banks' Association Bulletin Vol. XIX No. 3, March 1997 (Special Issue on Customer Service in Banks) and performance Highlights of Banks 1996-97, IBA publication and Annual Reports of State Bank Of India, Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97 and RBI Bulletin December 1997

term deposits. It is unique because it is a hybrid scheme. Product innovation and customization to suit the needs of the major clients hold the key to competition in the emerging environment. The latest in the list of innovations is a deposit scheme, having the convenience of exercising multiple options, operationalised at all computerised branches of SBI from the 1st July 1998 for meeting the requirements of personal banking customers. Personal Investment Centres (PICs) covering investment counselling and portfolio management was extended further taking the network of PICs to 18 apart from the 4 Personal Banking Centres in Bombay, Madras, Hyderabad and New Delhi. Thus in addition to large network of branches, product innovation, customisation, marketing of deposit schemes, computerisation of branches and efficient product delivery have contributed to mobilisation of deposits by SBI.

A representation of the State Bank Of India domestic deposits growth in the post-reforms period i.e. 1991-92 upto 1996-97 is given below by the following bar-diagram:



State Bank Of India : Domestic Deposits

Bar Diagram Representation of Growth

From 1991-92 to 1996-97

Diagram prepared on the basis of the table given on the previous page

The above bar-diagram shows a consistently good performance on the part of State Bank Of India in regard to its domestic deposits. In 1991-92, it had already crossed Rs. 50,000 crore mark in deposits and it crossed Rs.1,00,000 crore mark in 1996-97.

5.2.2.1 Market Share in Total Deposits

The market share of selected banks / bank groups in 1991-92 and 1996-97 is given in the following table :

Market Share in Domestic Deposits:

Banks / Bank Groups 11

Banks / Bank Groups	1991-92 Market Share in %	1996-97 Market Share in %
State Bank Of India	22.6	20.5
Associate Banks	6.2	7.4
19Nationalised Banks	59.0	54.7
Old Private Banks	5.1	7.4
New Private Banks	--	2.6
Foreign Banks	7.1	7.4
All Total Sch. Com. Banks	100.0	100.0
Bank Of India	5.5	4.9
Oriental Bank Of CommerceCommmerce	1.5	2.0

The market share of State Bank Of India in domestic deposits declined from 22.6% in 1991-92 to 20.5% in 1996-97. The share of nationalised banks in the market also declined from 59% in 1991-92 to 54.7% in 1996-97. All other bank groups gained in the market share of domestic deposits e.g. associate banks of SBI from 6.2% to 7.4% , old private banks from 5.1% to 7.4% and foreign banks from 7.1% to 7.4% during the aforesaid period. As regards other two selected banks, Bank Of India had a decline in the market share from 5.5% to 4.9% but Oriental Bank Of Commerce gained from 1.5% to 2% during the aforesaid period.

SOURCES: 11.

Same as item No. 10 and partly self calculated

5.2.2.2 Composition of Deposits

The composition of demand and time deposits of the three selected banks in 1991-92 and 1996-97 is given in the following table :

Composition of Demand and Time Deposits 12

Name of the Banks	1991-92 % of Demand to Total Deposits	1991-92 % of Time to Total Deposits	1996-97 % of Demand to Total Deposits	1996-97 % of Time to Total Deposits
State Bank Of India	48	52	42	58
Bank Of India	36	64	36	64
Oriental Bank Of Commerce	37	63	32	68
Total Scheduled Commercial Banks	35	65	34	66

Thus time deposits, which involve higher cost of finds have increased in case of State Bank Of India from 52% in 1991-92 to 58% in 1996-97 and also in respect of Oriental Bank Of Commerce from 63% to 68% but Bank of India maintained the same level of 64% for time deposits in the aforesaid years. For SBI, the higher proportion of demand deposits than the aforesaid two public sector banks and total scheduled commercial banks is a strong point. It is a strong favourable factor for increasing the interest spread and generation of higher profitability. With deregulation of interest rates on term deposits for more than 30 days and general trend of increasing proportion of time deposits, commercial banks have to carefully work out interest rates to ensure economic viability of their operations and at the same time maintaining the competitive edge.

SBI market share in Non-Resident Indians (NRI) deposits improved to 29.2% in 1993-94 from 26.4% in 1992-93 and touched Rs. 6,957 crore. Six new NRI branches were opened during 1993-94 taking the total number of NRI branches to 8. The NRI deposits of the Bank recorded a further growth of 18% and 29.7% taking the total NRI deposits at Rs.9,903 crore and Rs, 12,848 crore during 1995-96 and 1996-97 respectively.

Thus State Bank Of India continues to remain the market leader in mobilisation of deposits, commanding finds nearly one-fifth of the ASCB deposits with (a) a higher proportion of demand deposits, which are low cost and (b) more than half of personal segment deposits, which are stable.

SOURCES :

12. Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for 1991 -92 and 1996-97 and IBA Bulletin Vol. XIX No.3 March 1997 and Performance Highlights of Banks 1996-97.

5. 2 .3 BANK CREDIT

Bank credit plays a crucial role in deployment of funds of commercial banks. The yield is normally higher in bank's credit than in any other use but element of risk has to be properly managed. The aggregate bank credit in India in respect of State Bank Of India and other Bank Groups and 2 selected commercial banks is given in the following table.

State *Bank Of India : Advances in India :*
Comparative position in Post-Reforms Period 13

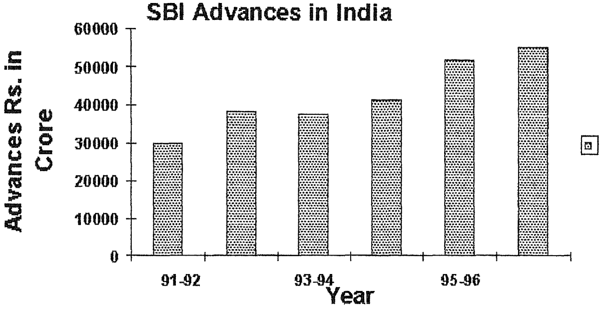
(Amount in crore of rupees)

Banks / Bank Group	1991- 92	1992-93	1993-94	1994-95	1995-96	1996-97	Average % increase 1992-97
State Bank Of India	29,854	38,300	37,532	41,214	51,813	55,023	16.9
Associate Banks	9,692	11,497	12,929	17,123	19,749	20,668	22.6
Nationalised Banks	76,555	83,852	85,237	1,09,504	1,15,676	1,18,599	11.0
Old Pvt. Banks	6,237	7,835	9,706	13,817	17,340	20,547	45.9
New Pvt. Banks	--	--	--	--	4,890	7.812	59.7
Foreign Banks	9,182	10,410	11,453	15,327	22,392	26,759	38.3
Total Sch. Com. Banks	1,31,520	1,51,894	1,56,857	1,96,985	2,31,860	2,49,408	17.9
Bank Of India	6,767	7,327	7,460	9,376	11,689	14,363	22.4
Oriental Bank Of Commerce	1,763	2,219	2,567	3,529	4,672	4,886	35.4

At Rs. 29,854 crore, State Bank Of India advances recorded a small increase of 2.7% during 1991-92 as compared to a rise of 17.2% in 1990-91. The restricted credit dispensation was in line with a small increase of 5.6% in ASCB advances during the same period in terms of a consciously policy to pursue a process of balancing loans with resources. At Rs. 38,300 crore, SBI advances recorded a substantial increase of 28.3% during 1992-93. Both food and non-food advances increased by 74.3% and 26.7% respectively, the latter effectively meeting the accentuated credit demand for the industrial sector. SBI advances declined by 2%in 1993-94 to the level of Rs. 37,532 crore mainly due to a sharp decline of 54% ((against a rise of 74.3% in the previous year) in food credit. The net domestic credit of the Bank increased by 9.8% in 1994-95 and amounted to Rs. 41,214 crore due to revival of demand for industrial credit. Credit to all industry groups registered positive growth: consumer goods 45% and capital goods 40%. Basic industries like power, cement, petroleum, iron and steel, fertilizers, pharmaceuticals and consumer goods industries like paper, tea ,sugar and leather drew substantially higher credit from the Bank. With net domestic credit of Rs.

51,813 crore (growth of 25.7%) in 1995-96, SBI had market share of 22.3% of ASCB credit. In 1995-96 the credit expansion was also facilitated by cuts in cash reserve ratio (CRR). The credit offtake was, however, sluggish during 1996-97 and domestic credit of SBI amounted to Rs. 55,023 crore. The growth of 6.2% was much lower than the previous year. Food credit declined by 16.9% while non-food credit increased only by 9.3%. Industrial advances increased by 5% out of which engineering industries had the largest share of 14% followed by iron and steel industries at 11%. The average annual increase of 16.9% in aggregate advances in India from 1991-92 to 1996-97 in respect of SBI is better than 11% recorded by the nationalised banks as a group. The average annual increase in advances in India during the aforesaid period is better for other categories of scheduled commercial banks and highest increase has taken place in respect of new private banks (59.7%) followed by old private banks (45.9%)and foreign banks (38.3%). One of the reasons for higher growth of advances of the above banks has been their lower advances base.

Growth of SBI advances in India in the post-reforms period is presented by the following bar-diagram:



State Bank Of India : Advances in India Diagramatic Representation of growth during 1991-92 to 1996-97

It is evident from the above presentation that growth in advances in India by SBI was steady except in 1993-94 when there was a negative growth of - 2%.

5.2.3.1 Market Share in advances in India

Market share of different categories of scheduled commercial banks in India over a period of time

SOURCES:

13. Same as item No. 10

gives an idea of whether the concerned bank / bank groups maintained the growth rate in tune with the growth rate of their competitors. The market share of selected scheduled commercial banks / bank groups advances in India in 1991-92 and 1996-97 is given in the following table : 14

Market Share in Advances in India : Banks / Bank Groups

Banks / Bank Groups	1991-92 Market Share in %	1996-97 Market Share in %
State Bank Of India	22.7	22.1
Associate Banks	7.4	8.3
19 Nationalised Banks	58.2	47.6
Old Private Banks	4.7	8.2
New Private Banks	--	3.1
Foreign Banks	7.0	10.7
All Total Sch. Com. Banks	100.0	100.0
Bank Of India	5.1	5.8
Oriental Bank Of Commerce	1.3	2.0

Market share in total advances in respect of State Bank Of India marginally declined from 22.7% in 1991-92 to 22.1% in 1996-97. The major loss took place in respect of nationalised banks, whose share declined from 58.2% to 47.6% during the aforesaid period. Inroads in their share have been made by the gains of Associate Banks of SBI from 7.4% to 8.3%, old private banks from 4.7% to 8.2%, new private banks from nil to 3.1% and foreign banks from 7% to 10.7%. 15

With the vast expanding middle class consumers with higher consumer spendings the Bank had set up Consumer Finance Centres in 6 cities for effectively marketing various schemes of the Bank and total consumer finance of the Bank stood at Rs. 558 crore in 1994-95 accounting for 11.3% of the personal segment

SOURCES:

14. **Same as item No. 13**

15. **Same as calculated from the source quoted in item No. 13**

advances. The maximum loan amount available under the Big Buy Scheme for purchase of consumer durables and the Car Loan Scheme was also increased and terms of the Schemes liberalised. Another thrust area was the housing loan finance, for which 497 branches were identified as intensive centres. A special scheme was also launched to extend coverage of housing finance in the rural areas. Credit card business also offers immense scope for the Bank. To capture this emerging opportunity, SBI has launched credit card jointly with GE Capital cristened "SBI Card" in October 1998 in Delhi. It will provide the Bank a vehicle to enlarge the personal banking segment. 16

5.2.3.1 SECTORAL DEPLOYMENT OF CREDIT

(a) Industrial Finance :

The financial assistance by SBI to industrial sector is diversified and covers basic industries, consumer goods industries, capital goods industries, intermediate and other industries. The Bank's aggregate industrial finance to large and medium industries amounted to Rs. 18,426 crore in March 1992 and it increased by 34% in 1992-93. Credit expansion was highest for the basic industries group, which determines overall industrial growth. Basic industries accounted for Rs. 7,565 crore, about 31% of Bank's aggregate industrial advances. Engineering industries enjoyed credit of Rs. 5,508 crore i.e. over 22% of bank's industrial lending in 1992-93. Cotton and other textiles, electronics and sugar are other major industries to whom credit has been extended by SBI. During the year 1993-94, the Bank's loans to large and medium industries declined by 2.1%. reflecting the general trend of low corporate credit growth. During the year 1994-95, there was an overall growth of 22.6% in the outstanding credit of the Bank and industrial finance accounted for 63% of the Bank's gross credit. The increase in advances of industrial sector was 29% in 1995-96 and the share of engineering industries to total Bank credit increased to 25%. The increase in advances to the above sector was only 5% in 1996-97 due to depressed market for credit. 17 The financing of the software industry, which is making rapid technological strides, is receiving attention of the Bank.

Three Strategic Business Units (SBUs) of State Bank Of India viz. Corporates Accounts SBU, Leasing SBU and Project Finance SBU are finctioning as parts of Corporate Banking Group (CBG)with focussed attention on top corporate customers. The setting up of these specialised units with appropriate strategies and capabilities is in fitness of things to meet the banking needs of large corporate customers. The finctions of these units are given below:

SOURCES:

16. Financial Express dated 16th October 1998

17. State Bank Of India , Annual Reports 1991-92 to 1996-97

Corporate Accounts Group (CAG) 18

CAG, an exclusive outfit for top corporates, provides a one-stop shopping for all financial services to its customers through a delayered credit process and 'Quality Related Management.' Delivery of core products in a comprehensive, timely and cost effective manner relative to competitors is made through dedicated branches known as CAG branches.

Leasing SBU 18

Leasing SBU of SBI has booked business covering diversified segments of industry and highly rated corporates from all over the country. The equipments have been leased out to corporates, both in public and private sectors, engaged in infrastructure development and certain manufacturing industries.

Project Finance SBU 18

Project Finance SBU is targeting the delivery of the entire range of project finance related services from project advice to domestic and also cross border financing and syndication. Its attention is mainly focussed on the fast growing **infrastructure industries** that are characterised by long gestation period e.g. power generation, telecommunication, oil and refinery products, petro-chemicals, roads and ports.

The above highly sophisticated functions of State Bank Of India can be termed as its core competencies.

In addition to the above, bulk of the proceeds of Resurgent India Bonds (RIBs) is also likely to be earmarked for financing infrastructural projects and it has been discussed subsequently in the context of the aforesaid Bonds.

(b) Priority Sector Lendings:

Priority sector lendings have their importance in developing economies and these have also been termed as 'directed lending' by some economists. This financing represents social aspect of lending. The priority sector advances are composed of advances to agriculture, small scale industries and small business and other weaker sections of the society. The amount of priority sector lending and percentage to total bank

SOURCES:

18. State Bank Of India , Annuals Reports 1996-97 and 1997-98

credit by State Bank Of India Bank Of India, Oriental Bank Of Commerce and other bank groups during 1991-92 and 1996-97 are given in the following table:

Priority Sector Lendings : Selected Bank-Groupwise : Comparative position 19

(Rs. in crore)

Banks / Bank-Group	1991-92 Amount	1991-92 % to total advances	1996-97 Amount	1996-97 % to total advances
State Bank Of India	11,646	39	19,337	38
Public Sector Banks	43,573	38	79,131	42
Old Private Banks	1,798	28	6,074	43
New Private Banks	--	--	2,623	38
Foreign Banks	712	8	6,129	37
Bank Of India	2,545	40	5,044	44
Oriental Bank Of Commerce	740	40.43	2,055	42

SBI advances to priority sector registered an increase from Rs. 11,646 crore in 1991-92 to Rs. 19,337 crore in 1996-97, though these advances as percentage to total advances have marginally decreased from 39% to 38.3% over the above period and also falling marginally short of the target of 40%. Among bank-groups, old private sector banks had granted largest proportion of their total credit viz. 43% to priority sector. Among the selected banks, Bank Of India had the largest proportion of priority sector advances i.e. 44% of their bank credit. While financing priority sector advances, it must be ensured that the proposals are economically viable and required assets are created out of bank's loan so that repayment of advances is ensured. State Bank has been a pioneer in financing these sectors and credit extended for these segments has been analysed in the following paragraphs.

* *Advances to Small Scale Industries :*

State Bank Of India devised in 1956 a Pilot Scheme for financing small scale industries for intensive SSI financing at 9 centres. After reviewing the position in 1957, a liberalised scheme for assistance to SSI units was devised and viability of the unit and need-based approach became the criteria instead of security-

SOURCES:

19. Report on Trend and Progress of Banking in India 1996-97 (July - June), Reserve Bank Of India and Annual Reports of State Bank Of India, Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97 and Indian Banks' Association Bulletin Vol. XIX, No.3, March 1997

oriented approach. Bank's financial assistance outstanding from 1991-92 to 1996-97 to small scale industries is given in the following table:

Advances to Small Scale Industries by State Bank Of India 20

(Rs. in crore)

Year	Advances to Small Scale Industries
1991 - 92	5,069
1992-93	5,463
1993-94	5,837
1994-95	6,779
1995-96	7,790
1996-97	8,622

Advances to small scale industries by State Bank Of India amounted to Rs. 5,069 crore in March 1992. The number of units assisted were 10.37 lakh. Smaller units predominated and 67% of the units financed by the Bank had limits upto Rs. 25,000 only. Artisans, village and cottage industries accounted for financial assistance worth Rs. 138 crore covering 3.71 lakh units. The Bank also provided export credit to the SSI sector, which covered such diverse activities as marine food products, knitwear, ready-made garments, leather goods, computer software, dyes and castings etc. Bank advances to SSI units rose to Rs.6,779 crore in 1994-95 to Rs. 7,790 crore in 1995-96 covering over 10 lakh units. SBI advances further rose to Rs. 8,622 crore during 1996-97, 8% higher than the previous year. Advances to SSI sector by SBI crossed Rs. 10,000 crore mark (Rs. 10,014 crore) in 1997-98 i.e. growth of 16.1% over the previous year.

Besides meeting financial requirements of the small and medium enterprises, the Bank also plays a catalytic role in technology upgradation of these enterprises through its Industrial Technology Group (Project Uptech Group) set up in 1988 to direct and guide programmes aimed at facilitating technology upgradation in selected industrial clusters. Upto 1996-97, the group has implemented seven projects in selected clusters. It has launched a Quality Support Scheme to encourage deserving units in improving the quality of their output and obtain ISO certification. Bank provides equity fund support to selected small scale industries under its Equity Fund Scheme. At the end of March 1992, 8296 units had been assisted to the tune of Rs. 104.28 crore under this Scheme. SBI organises Entrepreneurial Development Programmes in its lead districts and in backward districts to motivate first generation entrepreneurs to set up ventures. Bank had conducted 181 such programmes covering 4,688

SOURCES:

20. State Bank Of India , Annuals Reports 1991-92 to 1996-97

entrepreneurs. The programme focus is partly for developing entrepreneurs to set up ancillaries near large projects and high-tech industries such as electronics and computer peripherals. Bank's Consultancy Cells extend specialist support to the Bank's operations in the small and medium scale industries sectors ; both to the Bank's officials in project evaluation, follow-up and nursing of sick units etc. as also to the clients by way of counselling and special training programmes for them. The Bank lays emphasis on encouraging women entrepreneurs. It had assisted women entrepreneurs to the extent of 164 crore covering 2.6 lakh accounts upto 1993-94.

** Agriculture Finance :

Agricultural sector occupies an important position in India economy. Agriculture feeds the population of the country and provides raw materials for the agro-based industries. State Bank Of India is pioneer in rural credit as in the case of small scale industries. In sixties, the Bank opened dedicated branches for agriculture known as Agricultural Development Branches (ADBs), which are located in rural areas and make exclusive lending to agricultural and allied agricultural activities. In 1991-92 the advances at the Bank's 427 ADBs stood at Rs. 1,170 crore covering 15.62 lakh farming accounts. The ADBs, which constituted about 5% of the Bank's total branch network, accounted for nearly 24.5% of its total agricultural advances. In addition to this, agricultural banking divisions devoted to agricultural advances have also been created at selected branches. Advances to agricultural sector by State Bank Of India is given in the following table:

Advances to agricultural sector by State Bank Of India 21

(Rs. in crore)

Year	Advances to agricultural sector
1991 - 92	4,780
1992-93	5,235
1993-94	5,524
1994-95	6,018
1995-96	6,749
1996-97	7,807

Bank's total advances to agriculture stood at Rs. 4,780 crore at the end of March 1992 recording an increase of Rs. 435 crore over the previous year. Direct agricultural advances increased from Rs. 4,087 crore

SOURCES:

21. Same as item No. 19

in March 91 to Rs. 4,474 crore at the end of March 1992 constituting 15% of the Bank's total credit. The number of direct agricultural advances also increased from 53.77 lakh to 58.85 lakh. Indirect agricultural advances to Primary Agricultural Credit Societies, Farmers Service Societies, other corporations and agencies stood at Rs. 306 crore in March 1992, as against a level of Rs. 258 crore in March 1991. The Bank's agricultural advances increased to Rs. 5,524 crore in 1993-94, out of which 47% agricultural advances were in backward districts distributed among 32 lakh borrowal accounts. The agricultural advances further increased to Rs. 7,807 crore in 1996-97, an increase of 63% over a period of 5 years. The Bank has also laid emphasis on financing high-tech projects like acqua-culture, horticulture, sericulture, vermiculture, tissueculture and mushroom cultivation. The Bank has two specialised branches at Madras and Hyderabad to cater exclusively to the needs of high-tech agriculture.

Due to vigorous follow-up, recovery of agricultural advances, which stood at 54.1% at end-June 1993 increased to 60% during July 1995-June 1996 and it was expected to further increase to 62% during July 1996-June 1997.

Service Area Approach (SAA) as on 31st March 1992 was being implemented at the Bank's 6,488 rural, semi-urban and a few urban branches covering 1,06,095 villages all over the country. Another, 57,795 villages, which were allotted to Regional Rural Banks have also been allotted to these branches for financing Non-Target Group beneficiaries. **The branch level credit plans** for 1991-92 were drawn and the aggregate of credit plans for all segments worked out to Rs. 1,947 crore including Rs. 1,193 crore for agricultural and allied activities. Bank has also provided credit support for various **agricultural development programmes,** including schemes formulated by the Government. The **schematic lending** covered provision of irrigation and modernisation of farm practices to upgrade farming technology. Other important programmes of national relevance covered were oilseeds development programme, dryland farming and wasteland development. The **SBI Green Card Scheme** was launched in 1990 on a pilot basis at a few selected Agricultural Development Branches and at branches with agricultural banking divisions to provide essential liquidity to farmers in procuring agricultural inputs. The Scheme was well received and has been extended to other branches with sizable agricultural business. Under the **Integrated Rural Development programme (IRDP)** as in March 1997, over Rs. 2,503 crore were disbursed in the aggregate to about 64 lakh beneficiaries. The Bank continued to discharge its lead bank responsibility in 109 districts and convenorship responsibility for State Level Bankers' Committee Meeting in 9 States and 2 Union Territories.

** *Small Business Finance :*

In the tertiary sector, Bank provides credit assistance to retail traders, transport operators, professionals and other with a view to creating self-employment opportunities. Advances to small business finance by State Bank Of India is given in the following table: 22

SOURCES:

22. State Bank Of India , Annuals Reports 1991-92 to 1996-97

Advances to Small Business Finance by State Bank Of India

(Rs. in crore)

Year	Advances to Small Business Finance
1991 - 92	1,742
1992-93	1,748
1993-94	1,806
1994-95	2,030
1995-96	2,414
1996-97	2,794

. Bank's advances to such small business units stood at Rs. 1,742 crore spread over 21.58 lakh accounts in 1991-92. Such advances have consistently increased and amounted to Rs. 2,794 crore in 1996-97 an increase of 60.4% over a period of five years.

*** ***Export Credit :***

Exports continue to be a thrust area in Indian economy and as such SBI has laid great thrust on export finance as would be observed from the following table:

Export finance by State Bank Of India (Rs. in crore) 23

Year	Export Finance
1991 - 92	2,485
1992-93	4,365
1993-94	4,847
1994-95	6,311
1995-96	6,955
1996-97	6,229

SOURCES:

23. Same as item No. 18

SBI had provided total export credit amounting to Rs. 2,485 crore during 1991-92, which increased to Rs. 4,847 crore as at the end of 1993-94, constituting 13% of the Bank's loan portfolio, surpassing the 10% benchmark stipulated by Reserve Bank Of India. Total export credit of the Bank increased to Rs. 6,955 crore at March-end 1996 representing a market share of 23%. The bank continued to play a major role in financing export of engineering goods on deferred payment terms, execution of turnkey projects and civil construction contracts abroad by Indian companies. 24 The sluggish growth in the country's exports in 1996-97, impacted the Bank's export credit and it recorded a decline of about 10% reaching the level Rs. 6,229 crore. India's export growth remained sluggish in 1997-98 as well and consequently, SBI's export credit amounted to Rs. 7,151 crore in 1997-98 recording a modest increase of 14.8% and as a proportion of net Bank credit, it accounted for 10.36%.

5.3 OPERATIONS OF FOREIGN OFFICES OF SBI

Globally, SBI's objective is to become a world class bank with excellence in India-related business. Keeping this in view, its foreign offices are mainly engaged in the following services :

(a) Providing investment and trade advisory services,

(b) Providing project export finance under the aegis of multilateral funding agencies,

(c) providing correspondent banking services to Indian banks and

(d) diversifying traditional business and ensuring increased customer satisfaction through technology upgradation.

The Bank's foreign offices (52 offices in 33 countries), which mainly cater to the needs of the country's foreign trade and provide foreign currency resources to the Indian corporates, have improved their performance. The deposits of foreign offices of SBI, which amounted to Rs. 3,906.94 crore by the end of March 1992 increased to Rs. 6,933.83 crore (US $ 1,930.89 million) in 1996-97 registering an increase of 77.5% over a period of 5 years. The advances portfolio of the Overseas Offices was Rs. 7,210.19 crore (US $ 2,007.85 million) in 1996-97 and their investments amounted to 1,115.13 crore (US $ 310.54 million) as on end March 1997. The foreign offices of SBI earned a net profit of Rs. 143.58 crore (US $ 39.98 million) in March 1997, recording an increase of about 55% over the previous year. 25 Assets of the Bank's foreign offices (excluding Subsidiaries and Joint Ventures) at end-March 1998 constituted 18.1% of its global assets and these Offices contributed 8.7% to the Bank's net profit.

The Return on Assets (ROA) of the foreign offices as per operating profits at end-March 1998 stood at 0.76% as against 0.76% at end-March 1997.

SOURCES:

24. State Bank Of India , Annual Report 1995-96

25. State Bank Of India , Annual Report 1996-97

State Bank Of India has three wholly owned subsidiaries and four joint ventures abroad listed below:

Subsidiaries Abroad : 26

(a) SBI European Bank PLC

(b) SBI Canada

(c) SBI California

Joint Ventures Abroad :

(a) Nepal SBI Bank

(b) Bank Of Bhutan

(c) SBI International Ltd. Mauritus

(d) Indo Nigerian Merchant Bank Ltd. (Lagos)

In addition, SBI benefits from relationship with a group of more than 900 correspondent banks worldwide.

5.4 Credit - Deposit Ratio :

Other factors having a bearing on profits are credit-deposit ratio as bank credit is still the highest earning asset of banks. The table containing credit deposit ratio of SBI and other banks / bank groups is given below:

Credit - Deposit Ratio : Bank Groupwise : Comparative Position 27

Banks /Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
State Bank Of India	73.67	71.92	54.31	57.01	62.06	59.70
Associate Banks	61.04	59.60	52.10	57.50	57.56	55.57
Nationalised Banks	56.45	53.34	45.77	48.00	49.28	45.56
Old Private Banks	52.45	51.81	48.83	52.90	57.82	54.88
New Private Banks	--	--	--	--	82.33	59.67
Foreign Banks	54.42	49.98	44.32	54.84	73.68	71.57
All Sch. Com. Banks	60.35	57.54	48.13	54.70	58.60	55.10
Bank Of India	65.45	59.18	50.99	49.87	56.67	57.35
Oriental Bank Of Com.	48.99	51.89	49.00	52.88	53.63	48.60

SOURCES: 26. State Bank Of India Annual Report 1996-97

27. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97 , IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97 and SBI Monthly Review April 1998 and Reserve Bank Of India Bulletin December 1997

It will be observed from the above that credit-deposit ratio in respect of the public sector banks has declined when data of 1991-92 as compared with the data of 1996-97. In case of SBI also this ratio has declined mainly due to higher growth rate of deposits as compared to the increase in credit offtake in the market. A general decline in CD ratio in post-reforms phase witnessed in the portfolios of scheduled commercial banks is, inter alia, attributed to more cautious approach adopted by banks in the context of IRAC norms. But it is only a temporary phenomenon and, in fact, in 1996-97 the decline is linked with deceleratrion in industrial activity. Further, domestic advances of SBI have increased by 19.3% in Marh 1998 over the previous year despite slowing down of industrial growth. CD ratio will further improve as soon as industrial sector recovers.

5.5 TREASURY AND INVESTMENT MANAGEMENT

Treasury operations include, apart from complying with the reserve prescriptions in the form of maintenance of CRR and SLR, residual cash management i.e. management of short term surpluses and deficits, performance of other investment functions with focus on profitability, risk management and delivery of various treasury products. The treasury and investment management functions have contributed to the Bank's overall operations in tune with various policy changes and developments in the financial markets. The Bank's total investments recorded a rise of 32.7% reaching the level of Rs. 23,917 crore during 1991-92. The Bank's investments in Government securities was 41.5%. In 1993-94 with slower credit growth and excess liquidity due to reductions in CRR (from 15% to 14%) and SLR (from 37.75% to 34.75% and incremental SLR from 30% to 25%), the Bank, for commercial reasons, stepped up its investment in Government securities from 23.4% to 38.1%. At Rs. 40,799 crore in 1994-95 and Rs. 42,909 crore in 1995-96, the Bank's investments registered a rise of 10.6% and 5.2% respectively. The Bank's investments in India grew by 6.5% and reached a level of Rs. 45,712 crore at end-March 1997. The bulk of the investments were in Government and other approved securities (90.7%) followed by investment in shares, debentures and bonds (7.4%) and investment in subsidiaries and joint ventures (1.9%). 28

Working towards internationally accepted accounting standards, SBI marked to market 70.9% of its SLR investments, well above the RBI norm of 50%. The Asset Liability Management Committee (ALCO) at the corporate level is engaged in formulation of a balance sheet policy for the Bank based on a detailed assessment of risk-return trade-offs. The ALCO also evolves appropriate systems and procedures for ongoing identification of market risks, finding risks and interest rate risks and lays down parameters for efficient management of these risks. 29

SOURCES:

28 & 29. State Bank Of India Annual Report 1996-97

5.6 PROFIT AND LOSS COMPONENTS

5.6.1 Total income

The various functions of the banks and pricing thereof determines the income of banks and has an important bearing on their profit / loss. The following table shows the comparative position of total income of State Bank Of India alongwith other selected public sector banks i.e. Bank Of India, Oriental Bank Of Commerce and other bank groups like 19 nationalised banks, old private banks, new private banks and foreign banks for the years 1991-92 to 1996-97 :

Total Income : Banks / Bank Groupwise Distribution

TOTAL INCOME [30] (amount in crore of rupees)

Bank Group / Banks	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	% average increase 1992-97
State Bank Of India	10,931	11,157	10,746	12,250	15,716	17,594	12.2
Associate Banks	2,498	2,806	3,162	3,698	4,851	5,683	25.5
Nationalised Banks	20,734	22,126	23,390	26,999	33,074	37,994	16.6
Old Private Banks	1,521	1,881	2,366	3,220	4,332	5,401	51.0
New Private Banks	--	--	--	--	1,000	1,980	19.6
Foreign Banks	3,709	3,938	4,086	4,668	6,085	7,590	21.0
All Sch. Com. Banks	39,393	41,908	43,750	50,835	65,058	76,242	18.7
Bank Of India	2,658	2,318	2,260	2,650	3,311	4,004	10.2
Oriental Bank Of Commerce	448	537	648	872	1,127	1,355	40.5

SOURCES:

30. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97 , IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97 and Reserve Bank Of India Bulletin December 1997

5.6 PROFIT AND LOSS COMPONENTS

5.6.1 Total income

The various functions of the banks and pricing thereof determines the income of banks and has an important bearing on their profit / loss. The following table shows the comparative position of total income of State Bank Of India alongwith other selected public sector banks i.e. Bank Of India, Oriental Bank Of Commerce and other bank groups like 19 nationalised banks, old private banks, new private banks and foreign banks for the years 1991-92 to 1996-97 :

Total Income : Banks / Bank Groupwise Distribution

TOTAL INCOME [30] (amount in crore of rupees)

Bank Group / Banks	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	% average increase 1992-97
State Bank Of India	10,931	11,157	10,746	12,250	15,716	17,594	12.2
Associate Banks	2,498	2,806	3,162	3,698	4,851	5,683	25.5
Nationalised Banks	20,734	22,126	23,390	26,999	33,074	37,994	16.6
Old Private Banks	1,521	1,881	2,366	3,220	4,332	5,401	51.0
New Private Banks	--	--	--	--	1,000	1,980	19.6
Foreign Banks	3,709	3,938	4,086	4,668	6,085	7,590	21.0
All Sch. Com. Banks	39,393	41,908	43,750	50,835	65,058	76,242	18.7
Bank Of India	2,658	2,318	2,260	2,650	3,311	4,004	10.2
Oriental Bank Of Commerce	448	537	648	872	1,127	1,355	40.5

SOURCES:

30. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97 , IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97 and Reserve Bank Of India Bulletin December 1997

Total income of State Bank of India has increased in absolute terms from Rs. 10,931 crore in 1991-92 to Rs.17,594 crore in 1996-97 an average increase of 12.2% over 5 years period. The fastest percentage increase from 1991-92 to 1996-97 has been in case of private banks followed by Oriental Bank Of Commerce. In addition to lower base, there has been a faster increase in their business levels. For State Bank Of India, higher base is the reason for lower average percentage increase. Still, growth in total income of SBI was steady except 1993-94 when there was decline of 4% due to lesser interest earned on account of negative growth of -2% in total advances and impact of IRAC norms.

The break-up statement of total income of State Bank Of India from 1991-92 to 1996-97 is given in the following table:

State Bank Of India : Break-up Statement of Total Income (Rs. in crore) 31

Particulars	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Interest earned	9,535 (87.2)	9,698 (86.9)	9,180 (85.4)	10,652 (87.0)	12,959 (82.5)	14,951 (85.0)
Other Income	1,396 (12.8)	1,459 (13.1)	1,566 (14.6)	1,598 (16.0)	2,757 (17.5)	2,643 (15.0)
Total Income	10,931 (100)	11,157 (100)	10,746 (100)	12,250 (100)	15,716 (100)	17,594 (100)

Interest income in absolute terms declined from Rs. 9,698 crore in 1992-93 to Rs. 9,180 crore in 1993-94 due to a fall of about 2% in the Bank's total advances during the relevant period. Interest income increased consistently and amounted to Rs. 14,951 crore in 1996-97; an increase of 15.4% over the previous year despite sluggish demand for bank credit. Interest income has two broad components (a) interest /discount on advances / bills and (b) income on investments. The income from investments, which constituted about 21.3% of total interest income in 1991-92 increased to 36.9% in 1996-97. The increase is due to higher investment in Government and approved securities and also due to higher returns on such securities. In the case of Bank Of India, investment income constituted 31.2% of total interest income in 1996-97, while in case of Oriental Bank Of Commerce it was higher at 39%.

As regards the share of non-interest income of SBI, it has increased from 12.8% in 1991-92 to a peak of 17.5% in 1995-96 and thereafter declined to 15% in 1996-97. The increase in ' other interest income ' also known as ' non-interest income ' in respect of SBI is due to increase in remittances by issuance of drafts etc.,

SOURCES:

31. State Bank Of India Annual Report 1991-92 to 1996-97

profit on sale of investments, commission on Government business, income earned by way of dividend etc. from subsidiaries /companies and / or joint ventures abroad / in India. The avenues like leasing, income from dealing in gold and international consultancy will further add to SBI's non-interest income with increase in turnover in future.

5.6.2 TOTAL EXPENDITURE

Total expenditure is another important determinant of the profits of banks. The operating expenses have to be kept in check for optimising profits. It is observed from the following table that total expenditure has been considerably contained by SBI and it was only 10.2% average per annum during the post reforms period i.e. from 1991-92 to 1996-97; only next to Bank Of India being 8% average per annum despite wage revision in 1995. The increase in average total expenditure has been highest in case of new private banks 103.4% due to initial establishment expenses followed by Old Private Banks (49.3%) and Oriental Bank Of Commerce (35.8%). Foreign banks also had a comparatively higher average annual increase of 21% during the period from 1991-92 to 1996-97, which is due to higher interest expended and higher operating expenses. The comparative position is given in the following table:

Total Expenditure : Banks / Bank Groupwise Distribution

TOTAL EXPENDITURE [32] (amount in crore of rupees)

Banks/ Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	% increase 1992-97
State Bank Of India	10,756	10,945	10,471	11,534	14,884	16,265	10.2
Associate Banks	2,427	2,738	3,082	3,567	4,890	5,362	24.2
Nationalised Banks	20,134	25,774	28,095	26,730	34,235	36,549	16.3
Old Private Banks	1,440	1,820	2,236	2,878	3,941	4,992	49.3
New Private Banks	--	--	--	--	833	1,694	103.4
Foreign Banks	3,322	4,838	3,582	3,971	5,336	6,801	21.0
All Sch. Com. Banks	38,079	46,115	47,466	48,680	64,119	71,663	17.6
Bank Of India	2,601	2,649	3,349	2,600	3,035	3,644	8.0
Oriental Bank Of Commerce	421	517	616	759	954	1,175	35.8

SOURCES : 32. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97 , IBA publication and Annual Reports of State Bank Of India 1991-92 to 1997-98, Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97 and Reserve Bank Of India Bulletin December 1997

The break-up of total expenditure of State Bank Of India for the years 1991-92 to 1996-97 is given in the following table:

State Bank Of India : Break-up Statement of Total Expenditure 33

(Rs. in crore)

Particulars	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Interest Expended	6,089	6,727	6,264	6,688	8,226	9,592
Operating Expenses	2,254	2,576	2,949	3,611	4,460	4,605
Provisions & contingencies	2,413	1,642	1,258	1,235	2,198	2,068
Total Expenditure	10,756	10,945	10,471	11,534	14,884	16,265

Interest expended decreased from Rs. 6,727 crore in 1992-93 to Rs. 6,264 crore in 1993-94 mainly due to lesser interest payment on Reserve Bank Of India and inter-bank borrowings etc. The operating expenses were considerably contained in 1996-97 i.e. only an increase of 3.2%. The provisions and contingencies amounted to Rs. 2,413 crore in 1991-92 (highest in the post reforms phase) as against Rs. 1,266 crore in 1990-91 i.e. an increase of 90.6% due to stringent provisioning requirements in terms of Income Recognition and Assets Classification (IRAC) norms. Thereafter, provisioning requirements decreased upto 1994-95. Provisioning requirement again increased in 1995-96 for all the public sector banks as a group due to higher provisioning on account of ' mark to market ' of their investment portfolios. The provisioning requirements again declined to Rs. 2,068 crore in 1996-97 and added to the profit of SBI. The higher net profit ratio of the SBI Group was mainly due to lower provisioning requirements - provisions and contingencies which as a proportion to total assets declined from 1.67% in 1995-96 to 1.37% in 1996-97. Besides, the lower increase in wage bill in 1996-97 contributed to the decline in the intermediation cost of the SBI Group from 3.10% in 1995-96 to 2.94% in 1996-97. " 34

(iii) Interest Spread (Net Interest) :

In order to further examine the profitability of the banks, we shall examine ' Interest Spread Ratio to

SOURCES :

33. State Bank Of India Annual Report 1991-92 to 1996-97

34. Reserve Bank Of India Bulletin , December 1997

Total Assets ' also known as ' Net Interest Ratio to Total Assets '. Interest spread represents surplus of interest income over interest expenses and it is a crucial factor affecting banks' profitability especially in a developing economy like India, where avenues of other income have yet have yet to be expanded. The Interest Spread as percentage to Total Assets of SBI and other banks / bank groups are given below:

Name of the Bank / Bank Group	Net interest income (Interest Spread) as % to Total Assets 35					
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
State Bank Of India	3.63	2.95	2.61	3.25	3.28	3.43
19 Nationalised Banks	2.86	2.02	2.17	2.73	2.92	2.97
Total Public Sector Banks	3.22	2.39	2.36	2.92	3.08	3.16
25 Old Private Banks	4.02	2.91	2.97	3.04	3.14	2.96
9New Private Banks	--	--	--	1.17	2.84	2.91
34 Private Banks	4.02	2.91	2.97	2.69	3.08	2.94
39 Foreign Banks in India	3.92	3.56	4.21	4.24	3.74	4.09
100 Sch. Com. Banks	3.31	2.51	2.54	3.00	3.13	3.22
Bank Of India	2.25	1.82	2.07	2.81	3.01	3.21
Oriental Bank Of commerce	4.29	2.83	3.29	3.81	3.80	3.89

It is observed from the above table that Interest spread as percentage to total assets is the strong point for State Bank Of India. Immediately after start of the reforms phase, it had undergone a decline from 3.63% in 1991-92 to 2.95% and further to 2.61% in 1992-93 and 1993-94 respectively mainly due to compression of interest income due to introduction of IRAC norms at the industry level. Thereafter, it staged a recovery and reached 3.43% in 1996-97. It is higher in respect of SBI as compared to other public sector banks and private sector banks and also industry average for SCBs in 1996-97. Foreign banks group had a higher interest spread percentage to total assets (4.09%) as compared to SBI in 1996-97 for the obvious reason that they do not have obligations like rural branches with low earning lendings and their non-performing assets are much lower. Foreign banks do have obligation of priority sector but it comprises of small scale industries and export finance.

5.7 NET PROFIT

State Bank Of India has consistently improved its position in respect of net profits which increased from nationalised banks and all scheduled commercial banks as a group were in red. SBI further consolidated its position when its net profits increased from Rs.175.05 crore in 1991-92 to Rs. 212.04 crore

SOURCES :

35. Report on Trend and Progress of Banking in India July - June 1996-97 , Reserve Bank Of India

in 1992-93 thereby registering an increase of 21.1% Its net profits increased to Rs. 275.04 crore (29.7% increase) in 1993-94 and to Rs. 715.50 crore in 1994-95 (160.1% increase). Net profits further increased to Rs. 831.60 crore and Rs. 1,329.30 crore during 1995-96 and 1996-97 respectively registering an increase of 16.2% and 59.8% over the previous years. Net profit further increased to Rs. 1,861.20 crore in 1997-98 , registering an increase of 40%. The major contributing factors for improved net profit have been an alround improvement in the Bank's performance viz. higher interest income from advances as well as investment operations, higher non-interest income, lower operating cost and good performance of foreign offices. In addition unlike the 1995-96, the Bank did not have to provide a heavy amount by way of investment depreciation on account of softening of interest rates. The comparative data of net profit of the selected banks / bank groups are given in the following table:

Net Profit : Banks / Bank-Groupwise : Comparative Position 36

NET PROFITS (Rs. in crore)

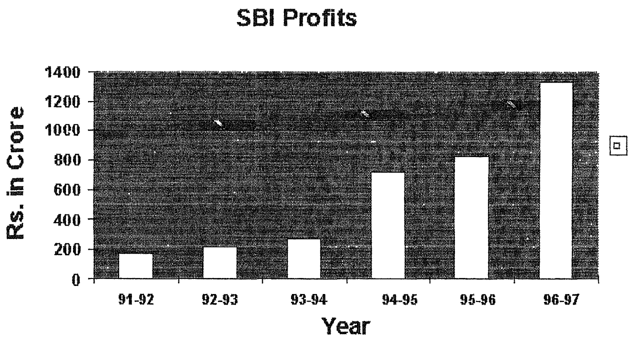
Bank / Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	Average % increase 1991-92 to 1996-97
State Bank Of India	175	212	275	716	832	1,329	131.9
Associate Banks	71	68	80	131	-39	321	70.0
Nationalised Banks	600	-3,648	-4705	269	-1,161	1,445	28.2
Old Private Banks	81	61	130	342	391	409	81.0
New Private Banks	--	--	--	--	167	286	71.2
Foreign Banks	387	- 899	504	697	749	788	20.7
All Sch. Com. Banks	1,314	-4,206	-3,716	2,155	939	4,578	49.7
Bank Of India	57	-331	-1,089	50	276	360	106.3
Oriental Bank Of Commerce	27	20	32	113	173	180	113.3

SOURCES:

36. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97 , IBA publication and Annual Reports of State Bank Of India 1991-92 to 1997-98, Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97 and Reserve Bank Of India Bulletin December 1997 and Report on Trend and Progress of Banking in India 1995-96 and 1996-97 (July - June)

The growth of net profit, as shown in the above table, has also been depicted by the following bar diagram :

State Bank Of India



Growth in Net profits : 1991-92 to 1996-97

The above diagram shows the consistency in growth of net profits of SBI. Net profit of State Bank India has increased from Rs. 175 crore in 1991-92 to Rs. 1329 crore in 1996-97, an average increase of 131.9% from 1991-92 to 1996-97. Growth has been faster during 1994-95 (160%) and 1996-97 (59.8). It is a great achievement keeping in view the income recognition, asset classification and provisioning requirements introduced in the wake of financial sector reforms. Another notable phenomenon is that SBI has consistently earned net profits in the post-reforms period, whereas other nationalised banks as a group incurred net losses during 1992-93, 1993-94 and 1995-96 and even foreign banks as a group incurred net losses during 1992-93. 37

5.8 FINANCIAL RATIOS

Financial ratios are important tools for examining health and efficiency of commercial organisations. The important financial ratios of State Bank Of India, Bank Of India and Oriental Bank Of Commerce, are given in the following table:

SOURCES:

37. State Bank Of India Annual Report 1991-92 to 1996-97 and Report on Trend and Progress of Banking in India 1996-97 (July - June) , reserve Bank Of India

Financial Ratios : Comparative Data

38

Indicators as % to total assets	1991-92 State Bank Of India	1991-92 Oriental Bank of Commerce	1991-92 Bank Of India	1996-97 State Bank Of India	1996-97 Oriental Bank Of Commerce	1996-97 Bank Of India
Gross Profit	2.72	2.43	1.41	2.17	2.60	1.53
Net Profit	0.18	0.67	0.24	0.85	1.56	0.95
Interest Income	10.03	10.54	10.18	9.55	10.82	9.26
Interest Spread	3.63	4.29	2.92	3.43	3.89	3.00

Gross Profit as percentage to total assets was highest for State Bank Of India among the three banks in 1991-92 but OBC has taken the top slot in 1996-97 with 2.60% as compared with 2.17% for State Bank Of India and 1.53% for Bank Of India. Net profit as percentage to total assets ratio of 0.85% for SBI is lower than the OBC's ratio of 1.56% and BOI' s ratio of 0.95% in 1996-97. The reasons for lower net profit as percentage to total assets in respect of SBI in March 1997 than OBC and BOI are its higher base of total assets. While interest income and interest spread of SBI are better than BOI but OBC's position is better because of lower NPAs.

The other financial ratios of SBI and other two selected banks in respect of expenses are also given in the following table:

Expense Ratios : Comparative Position of Selected Banks 39

Indicators as % to total assets	1991-92 State Bank Of India	1991-92 Oriental Bank of Commerce	1991-92 Bank Of India	1996-97 State Bank Of India	1996-97 Oriental Bank Of Commerce	1996-97 Bank Of India
Interest Expense	6.40	6.25	7.93	6.13	6.59	6.25
Provision as	2.54	1.76	1.16	1.32	1.04	0.58
Intermediati on cost	2.37	2.53	2.11	2.94	2.19	2.77

SOURCES:

38 & 39. Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the respective years and also Report on Trend and Progress of Banking in India, 1996-97 (July-June), Reserve Bank Of India

Interest expense as percentage to total assets is lowest in the case of SBI than BOI and OBC in 1996-97 due to lower cost of deposits because of lower of proportion of time deposits. Provisions as percentage of total assets is highest for SBI in March 1997 due to higher NPAS than OBC and BOI. But the positive signal is that it stands reduced in 1996-97 as compared to 1991-92. As regards intermediation cost as percentage to total assets in 1996-97, it is highest for SBI and has also increased when compared with 1991-92 data and as such it requires a better planning.

Improved earnings and profitability have a positive impact on the financial ratios. Return on assets and return on equity are linked with profits as percentage to assets and equity respectively. All these ratios have improved in respect of SBI as will be observed from the following table containing data in respect of SBI and other two selected banks:

Bank Groups / Banks : Financial Indicators : Comparative position 40

Indicators	1991-92 State Bank Of India	1991-92 Bank Of India	1991-92 Oriental Bank of Commerce	1996-97 State Bank Of India	1996-97 Bank Of India	1996-97 Oriental Bank Of Commerce
Return on assets %	0.185	0.243	0.670	0.880	1.01	1.56
Return on Equity %	11.97	0.849	23.49	16.77	18.57	19.14

The Return on Assets has improved in respect of SBI from 0.185 in 1991-92 to 0.880 in 1996-97 but ROA of Oriental Bank Of Commerce and Bank Of India have been higher both in 1991-92 and 1996-97. It shows higher net profit as percentage to total assets. Return on Equity of SBI has improved from 11.97% in 1991-92 to 16.77 in 1996-97. It is higher both for Bank Of India and Oriental Bank Of Commerce in the year 1996-97. The improved performance of SBI has reflected in Earning Per Share (EPS) from Rs.12.16 in 1993-94 to Rs. 15.09 in 1994-95, Rs.17.54 in 1995-96 and to Rs. 26.66 in 1996-97. The EPS of SBI is better than Bank Of India Rs. 6.03 in 1996-97.

SOURCES:

40. State Bank Of India Annual Report 1991-92 to 1996-97 and Report on Trend and Progress of Banking in India 1996-97 (July - June) , reserve Bank Of India

5.9 PRODUCTIVITY RATIOS

Productivity ratios show the productivity of employees. The net profit per employee regarding State Bank Of India, BOI and OBC are given in the following table :

Net Profit Per-Employee (Amount in Rs.) 41

Banks	1 9 9 1 -92 Net Profit Per-Employee	1 9 96 -97 NetProfit Per-employee
State Bank Of India	7,815	56,278
Bank Of India	10,576	67,548
Oriental Bank Of Commerce	24,666	1,33,000

The Profit Per Employee has significantly improved in respect of SBI from Rs. 7,815 in 1991-92 to Rs. 56,278 in 1996-97 despite the fact that its total number of staff was 2,36,204 in 1996-97. The Profit Per Employee is higher for Bank Of India and Oriental Bank Of Commerce for the aforesaid period. The total number of staff was 53,849 for Bank Of India and 13,580 for Oriental Bank Of Commerce in 1996-97.

The deposits per employee and advances per employee regarding State Bank Of India, BOI and OBC are given in the following table :

Deposit Per-Employee & Advances Per Employee : Bank Groupwise : Comparative Position 42

(Rs. in lakh)

Banks / Bank-Groups	1 9 9 1 - 92 Deposit per-Employee	1 9 9 1 - 9 2 Advances per-employee	1 9 9 6 - 97 Deposit per-employee	1 9 9 6 - 9 7 Advances per-employee
State Bank Of India	26.74	19.70	46.87	26.35
Bank Of India	35.88	23.48	59.37	34.05
Oriental Bank Of Commerce	33.15	16.24	74.04	35.98

Deposits per employee for State Bank Of India has improved from Rs. 26.74 lakh in 1991-92 to Rs. 46.87 lakh in 1996-97. It shows increasing productivity of the employees of SBI. The deposits and advances per employee are highest in respect of OBC (Rs. 74.04 lac and Rs. 35.98 lac respectively) in 1996-97 mainly due to its smaller set up.

SOURCES :

41 & 42. Annual Reports of State Bank Of India, Bank Of India and Oriental Bank Of Commerce for the years 1991-92 & 1996-97

5.10 NON - PERFORMING ASSETS (N P A S)

State Bank Of India has been according top priority to the management of Non-Performing Assets (NPA) with a view to improving the quality of its loan assets. It has adopted a two-pronged approach comprising preventive and curative measures to control Non Performing Assets (NPAs). Potential borderline accounts are quickly diagnosed and remedial measures initiated so that the accounts do not slip into the NPA category. Accounts secured by assets, which have lost or are likely to lose value, are monitored on an ongoing basis. The data of non-performing assets of the selected banks and other bank groups are given below:

Net Non-Performing Assets of Banks : Comparative Position: 43

Name of the Bank	1995-96 Net NPAs Rs. crore	1995-96 % of Net NPAs to net Advances	1996-97 Net NPAs Rs. crore	% of Net NPAs to Net Advances
State Bank Of India	3,921.27	6.61	4,524.57	7.30
State Bank Group	5,362.02	6.88	6,382.01	7.70
19 Nationalised Banks	12,935.47	10.14	13,902. 72	10.07
25 Old Private Banks	793.46	4.51	1,245.28	5.99
9 New Private Banks	--	--	161.41	2.07
39 Foreign Banks	182.91	0.81	670.63	2.50
Bank Of India	1,083.00	7.00	1,189.00	6.52
Oriental Bank Of Commerce	171.00	3.60	276.46	5.64

During the year 1996-97, the percentage of net NPA to net advances of SBI increased by 0.7% point to reach 7.3% at end - March 1997. This is mainly due to two reasons. First, slowdown of economic activity, particularly in the second half of 1996-97, which adversely affected the return flow of credit, and second, less than proportionate credit offtake during the year. The percentage of net NPAs to net bank credit in respect of SBI is better than State Bank Group and nationalised banks but the aforesaid ratio of Bank Of India, Oriental Bank Of Commerce, private banks and foreign banks are better than SBI in 1996-97.

SOURCES :

43. Report on Trend and Progress of Banking in India 1996-97 (July-June) , Reserve Bank Of India

As at the end-March 1998, the net NPAs to net loans of SBI decreased to 6.07% due to various preventive and curative measures initiatives by the Bank. In order to expedite disposal of cases transferred to Debt Recovery Tribunals, special legal cells have been created at Local Head Offices. A special Asset Recovery Department has started functioning in the apex office of SBI from August 1994. Its activities are geared towards reducing NPAs and maximising recoveries. The Bank has also put in place an elaborate credit audit process to ensure continuous improvement in the quality of its commercial credit portfolio. With a view to motivating its employees in recoveries and management of NPAs, the Bank formulated a scheme for award of cash prizes, certificates of merits and trophies to branches showing outstanding performance in this respect. 44

5.11 PRUDENTIAL STANDARDS

State Bank Of India has even done better than the prudential norms stipulated by Reserve Bank Of India. SBI has, during the year 1997-98, created a new prudential provision of 0.25% on the entire domestic assets thereby becoming the first amongst the Indian banks to do so. 45

5.12 RISK MANAGEMENT

State Bank Of India is committed to a healthy credit culture that recognises to ensure high asset quality. A major step in this direction is the introduction of the revised in-house Credit Risk Assessment (CRA) system, which captures financial risks as also other types of risks, such as industry risk in a borrowal account The system is well stabilised and covers a major part of the Bank's large commercial and industrial loan portfolio. In order to bring uniformity in the risk assessment methodology, the CRA system has also been extended to high value accounts in the SSI and agricultural segments as well. The Bank's credit portfolio is well diversified cutting across various industries with exposures in each category restricted to reasonable levels. Exposures to different industries are within limits set on the consideration of management of different risks and are kept under close monitoring.

5.13 CAPITAL ADEQUACY RATIO

The commercial banks in India are subject to risk-based capital adequacy guidelines issued by the

SOURCES :

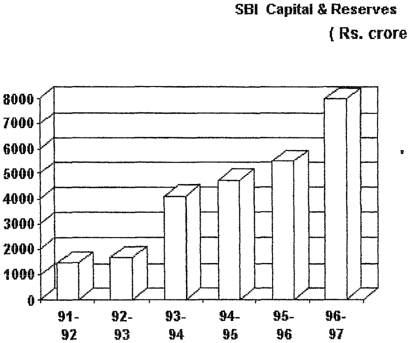
44. State Bank Of India , Annual Report , 1996-97

45. State Bank Of India

Reserve Bank Of India. These guidelines are used to evaluate capital adequacy based on the perceived risk associated with balance sheet assets as well as certain off - balance sheet exposures. The capital and reserves of State Bank Of India from 1991-92 to 1996-97 are depicted by the following bar-diagram :

State Bank Of India : Capital & Reserves

(Amount Rs. in Crore)



The above diagram shows a consistent increase in capital and reserves of SBI and it is due to the fact that SBI's approach to the capital adequacy standards has always been prudent and it is further confirmed from the following table:

State Bank Of India : Capital & Reserves [46] (Rs. Crore)

Year	Capital & Reserves	Percentage increase
1991-92	1,462	13.2%
1992-93	1,659	13.5%
1993-94	4,112	147.9%
1994-95	4,730	15%
1995-96	5,463	15.5%
1996-97	7,977	46%

SOURCES :

46. State Bank Of India , Annual Reports 1991-92 to 1997-98

The reason for a large increase of 147.9% in the capital and reserves of SBI during 1993-94 is SBI accessing the capital market. The State Bank Of India Act, 1995 was amended by promulgating an Ordinance in October 1993 to enhance the scope of the provision of partial private shareholding. SBI was the first public sector bank to access the capital market, to meet internationally established risk-weighted capital adequacy norms. It floated the largest ever issue of equity shares and bonds in the Indian stock market: Public Issue of the aggregated face value of Rs. 124 crore, a Rights Issue of Rs. 120 crore and an Employee's Share Issue of Rs. 12 core and floating interest rate bonds (aggregate value Rs. 500 crore). The floating rate bond was a first time instrument in the Indian capital market and intended to provide a built-in yield flexibility to the investors. The bonds issue was rated by both CRISIL and ICRA at the highest possible ratings AAA and LAAA respectively. Both the Equity and Bond issues received a very favourable market response and with the considerable over subscription that was partly retained, SBI's tier I Capital rose Rs. 3,742 crore from Rs.1,333 crore during 1993-94. Consequently, the Bank's Capital Adequacy ratio rose to 12.9% well above the 8% required. The increased capital base of the Bank has significantly increased its lending capability in terms of prudential norms. SBI continued to maintain a strong capital position during 1996-97 increasing from 11.60% in 1995-96 to 12.17% in 1996-97. Total capital (Tier I and Tier II) amounted to Rs. 11,150 crore at end-March 1998, representing 14.58% if risk weighted assets. 47

5.14 ISSUE OF GLOBAL DEPOSITORY RECEIPT

An important event for State Bank Of India has been successful floatation of the Global Depository Receipt (GDR) issue during October 1996. This was the first GDR issue by any commercial bank in the country. The objective was to augment the Bank's capital resources so as to enable it to operate in the competitive global environment on safe, sound and profitable lines. The GDR offering received enthusiastic response from global investors. and the Bank raised US $ 369.95 million. The resounding success of the GDR issue indicates global investors' confidence in the fundamentals of State Bank Of India. The Bank's GDRs are listed on the London Stock Exchange. 48

5.15 ISSUE OF RESURGENT INDIA BONDS

SBI has mobilised $ 4.16 billion through its Resurgent India Bonds (RIBs) in August 1998. While the bulk of its proceeds will be earmarked for financing infrastructure projects, the Bank would place approximately $1.00 billion (25% of total funds) abroad. One of the objectives would be to help

SOURCES :

47. State Bank Of India Annual Reports 1993-94 and 1996-97

48. State Bank Of India Annual Report 1996-97

Indian corporates in mobilising external commercial borrowings for infrastructure projects. 49

5.16 CONTINGENT LIABILITIES

Contingent liabilities of State Bank Of India amounted to Rs. 29,489 crore in March 1992 constituting 31.1% of the total liabilities / assets of the Bank. In March 1997 the amount of contingent liabilities increased to Rs. 42,399 crore 50 representing 29.3% of the total liabilities / assets. Liabilities on account of outstanding forward exchange contracts, guarantees given on behalf of the constituents in India and abroad, acceptances, endorsements and other obligations accounted for 92.7% of the total contingent liabilities in March 1997. As risk factors are increasing for all the banks under this head due to growth of non-fund based business, banks may devise suitable measures to manage the risks effectively.

5.17 USE OF MODERN TECHNOLOGY

Modern banking relies heavily for its existence as well as growth on information technology (IT). In today's context, without the use of information technology both product innovation and product delivery are bound to suffer. SBI has been a forerunner in the usage of modern communication media. Computerisation of SBI branches has, therefore, continued at a rapid pace. At the end of the year 1997-98, the Bank had fully computerised 1,211 branches, which included 1,009 urban and metropolitan branches out of 2,350 such branches of the Bank. The computerised branches accounted for 36% of the Bank's deposits, 58% of advances and 72% of foreign exchange turnover at end-March 1998. A significant development during the year 1997-98 was initiation of inter-branch connectivity programme. With branch computerisation in place, SBI launched customer-friendly products like cash management, multi-option deposits, tele - banking services and remote login facility for corporate customers. 51

The Bank has played a key role in the implementation of the Shared Payment Network (Swadhan). which is a network of ATMs of banks in Mumbai under the aegis of the Indian Banks' Association. Under the Swadhan, eight SBI ATMs have become operational. In all, the Bank had 23 ATMs spread over 14 important centres by March 1998.

Seventy three branches, handling 85% of the Bank's foreign exchange business have been connected to

SOURCES :

49. Economic Times dated August 26, 1998

50. State Bank Of India, Annual Reports 1991-92 and 1996-97

51. State Bank Of India , Annual Report 1997-98

SWIFT. SBI-e-Mail facility covers 10 Local Head Offices.

In order to support smooth transition to the use of new technology in the Bank, Satellite Training Centres have been set up at all Local Head Offices. These centres and the State Bank Institute of Information and Communication Management (SBIICM), the Bank's apex training institution in information and communication technology, trained a large number of employees in the use of information technology.

5.18 HUMAN RESOURCE DEVELOPMENT

The banking sector reforms have thrown open several opportunities as well as challenges. The success of the Bank's operations will ultimately depend on the quality of human resources or to better call it human capital. With a view to upgrade the knowledge and skills of its employees and to reorient their attitudes and for enhancing their competence and confidence to enable them to face the emerging challenges, SBI conducts training programmes at Staff Colleges and Staff Training Centres. During 1996-97, over 48,000 employees were exposed to about 2,400 training programmes conducted by the Bank at its various training establishments. It has a Human Resources Development Department at the apex office at Bombay. The training programmes are reviewed and redesigned from time to time so that these are relevant and have utility in the fast changing banking scenario. As part of the policy to recognise and reward excellence in performance, a scheme was introduced during 1997-98 for identifying and rewarding field officers (loan officers), who excel in performance of their jobs. This is in addition to the recognitions schemes already in effect for branch managers and other senior executives and the Multiple Reward and Recognition Scheme for branches and selected categories of their staff members.

5.19 CONCLUSION

Thus State Bank Of India has a long glorious history and tradition. It enjoys a dominant market position and unchallenged franchise in the Indian banking. The large network of branches of SBI spread over the country is a measure of strength. The Bank's domestic branches represent approximately 17.9% of all scheduled commercial bank branches in India (excluding RRBs) in March 1997. About 49.7% of the Bank branches are located in rural areas, 25.9% in semi-urban areas and 15.2% and 9.2% are in urban and metropolitan areas respectively. This widespread branch network enables the Bank to raise a substantial and stable deposit base to provide a wide range of lending products and other financial services and also to diversify lending risks geographically as well as by type of credit risk and customer. The Bank is also engaged in international banking having 52 branches in 33 countries in March 1998. In addition to these branches and offices abroad, it has three wholly owned subsidiaries and four Joint Ventures abroad.

SBI has approximately one fifth of all scheduled commercial banks deposits in India and about 73 % of deposits are from retail customers, reflecting its large customer base. The Bank has a larger proportion of demand deposits i.e. 42% as compared to Bank Of India 36%, Oriental Bank Of Commerce 32% and all scheduled commercial banks 34%. It is a strong positive factor for increasing the interest spread and net profits.

The Bank has about 22% share in all scheduled commercial bank advances in India. Growth rate of 19.3% in the Bank's total loan portfolio in 1997-98 is a good performance despite the deceleration in industrial output approximately from 6.4% in 1996-97 to 5.7% in the Indian economy in 1997-98.

SBI has not lagged behind in its social commitments. By the end of March 1997, the Bank had extended 38.3% of net Bank credit to priority sector, which mainly constitutes loans to agriculture, small scale industries, small business finance and weaker sections of the society. While SBI has been pioneer in financing agriculture and small scale industries since late fifties, the Bank has also ventured into areas like financing high-tech agriculture by opening specialised branches. Specialised branches have also been opened for meeting the requirements of other segments like Industrial Finance branches, Overseas Branches, Personal Segment Banking Branches etc.

Bank has reorganised itself according to the needs of the time. SBI has merited its status as the flagship of Indian banking and accordingly it has set its mission " to retain the Bank's position as the premier Indian financial services group, with world class standards and significant global business, committed to excellence in customer, shareholder and employee satisfaction, and to play a leading role in the expanding and diversifying financial services sector, while continuing emphasis on its development banking role." For this purpose, the Bank has continued to explore new areas and avail the emerging opportunities like leasing, project finance, dealing in gold, shipping finance, global link services and international consultancy. These activities have a positive impact on the Bank's interest and non-interest income. The Bank has also introduced a revised in-house Credit Risk Assessment (CRA) System.

SBI net profit has consistently increased from Rs. 175.05 crore in March 1992 to Rs. 1,349.25 crore in March 97 (average annual growth of 131.9%) and further to Rs. 1,861.2 crore in 1997-98. The financial ratios of SBI viz. Return on Average Assets (0.88 in 1996-97 and 1.09 in 1997-98), Return Average Equity (16.67% in 1996-97 and 19.37 in 1997-98), Earning Per Share (Rs. 26.66 in 1996-97 and Rs. 35.36 in 1997-98), Net Profit Per Employee (Rs. 56,278 in 1996-97 and Rs. 77,000 in 1997-98), Capital Adequacy Ratio (12.17% in 1996-97 and 14.58 in 1997-98) are strong indicators of strength of SBI

The bank has also diversified its functions and some of the important ones are given below :

(i) It acts as one of the nominated agencies for import of gold / silver under the Gold / Silver Jewellery Export Promotion and Replenishment Scheme of the Government Of India and its authorised branches supply gold to the exporters at international prices by way of replenishment against the gold / silver jewellery exports. The sale of gold to domestic consumers on bulk basis by the bank has also started from February 1998.

(ii) With a view to providing an efficient system for realising the proceeds of clean and documentary collections drawn on overseas centres, the Bank's International Division has begun a new specialised service known as Global Link Services (GLS). The service became operational during 1997-98 and offers correspondent banking products on matching terms with similar products of foreign banks. These services are expected to become a good source of profits in the coming years.

(iii) The Leasing SBU of the Bank provides lease finance as an additional product to top corporates both in public and private sectors and it covers a wide range of equipments. This area has good potential for future.

(iv) The Bank's Project Finance SBU is funding high value projects in infrastructure and core sector industries like power generation, telecommunication, oil and refinery products, petro-chemicals, roads and ports.

(v) The Bank has made significant progress in the area of international consultancy. Faculty support in international banking was provided to the National Banking College, Ghana and workshops on developmental banking were conducted for Egyptian bankers at Cairo.

(vi) The Bank has launched its credit card christened " SBI Card " at Delhi in October 1998 and it will be launched in other metros soon. The credit card will provide the bank with a vehicle to enlarge the personal banking segment.

(vii) SBI has mobilised $ 4.16 billion through its Resurgent India Bonds (RIBs) in August 1998. While the bulk of its proceeds will be earmarked for financing infrastructure projects, the Bank would place approximately $1.00 billion (25% of total funds) abroad. One of the objectives would be to help Indian corporates in mobilising external commercial borrowings.

The above areas give enhanced opportunities to State Bank Of India. But new areas require additional planning and also better risk management and assets liabilities management.

But some areas would require further improvements. While percentage of expenses to income has shown a welcome declining trend from 59.54% in 1995-96 to 57.54% in 1996-97 and further to 57.39% in 1997-98, there is still scope for further economy by availing economies of scale and further streamlining the systems for effecting economies in operating expenses.

Net Non-Performing Assets to net loans of the Bank rose from 6.61% in March 1996 to 7.30% in March 1997 and have thereafter decreased to 6.07% in 1997-98. But there is still scope for further improvement because backlog of old NPAs must have been cleared and new loan accounts constituting standard assets must be forming major part of the Bank's loan assets. The Bank must have conducted a study of agewise, segmentwise and areawise breakup of high value NPAs and legal cases pending in courts of law and it may review the progress by a structured machinery periodically.

The strength of SBI lies in its human resources, who are rated as one of the most competent and dedicated amongst all bank employees. But there is always scope for improvement. Greater thrust on business planning and marketing approach by the Bank have proved to be very useful.

However, with the opening of the banking sector to the foreign banks and new private banks in the wake of banking sector reforms, the competition has become keener. The loss of market share in deposits and advances by public sector banks including SBI in the post-reforms phase, as would be observed from tables 11 and 14 in the Chapter, are indicator to the business being attracted by the foreign banks and new private banks. The critical inputs like application of computer technology, customer service and process design would need to be closely examined and improved upon to meet the challenges arising out of competition.

Research and development are crucial areas, which require greater attention as these will be helpful in product development, innovations, systems redesign, costing and pricing of services and application of information technology.

Thus State Bank Of India with a glorious past tradition, dynamic present with the ability to diversify and avail the emerging opportunities, has a bright future ahead but much will depend upon the strategies to meet the competition, which has become keener with the arrival of the new players.

Chapter VI

Bank Of India : A Profile

6.1 Introduction

6.2 Important indicators of business growth

6.2.1 Branch network

6.2.2 Bank domestic deposits

6.2.2.1 Market share in domestic deposits

6.2.2.2 Composition of deposits

6.2.3 Bank credit in India

6.2.4 Sectoral deployment of bank credit

(a) Industrial finance

(b) Priority sector lendings

* Advances to small scale industries

** Small business finance

*** Agricultural finance

**** Export finance

6.3 International banking operations

6.4 Credit Deposit Ratio

6.5 Funds management and investment activity

6.6 Profitability Analysis

6.6.1 Total income

6.6.2 Total expenditure

6.6.3 Interest spread

6.7 Net profit

6.8 Non-performing assets (NPAs)

6.9 Financial ratios

6.10 Productivity Ratio

6.11 Capital adequacy ratio

6.12 Contingent Liabilities

6.13 Use of modern technology

6.14 Human Resources Development

6.15 Customer Service

6.16 Conclusion

CHAPTER VI

BANK OF INDIA : A PROFILE

6.1 INTRODUCTION

Bank Of India was founded on 7th September 1906 by a group of eminent businessmen of Mumbai. 1 Making an humble beginning with its first office at Mumbai, the Bank has taken rapid stride and grown into a bank with a strong national presence alogwith branches abroad. The Bank was nationalised on 19th July 1969 and it had 250 offices, aggregate deposit of Rs. 395 crore and total advances of Rs. 253 crore. 2 In March 1998, the Bank had 2,495 branches including 19 branches abroad located in 10 countries. Its aggregate deposits amounted to Rs. 39,339 crore and advances to the tune of Rs. 22,021 crore. Thus the bank has a strong profile. When compared with the nationalised banks, it is amongst the top ranking banks in that group but when compared with State Bank Of India, BOI ranks as a medium sized bank.

The Bank has the following nine Subsidiaries / Associates / Affiliates / Joint Ventures in India / abroad (five in India and four abroad): 3

(i) Bank Of India Finance Ltd. (Fully Owned Subsidiary in India)

(ii) Bank Of India Asset Management Co. Ltd. (Fully Owned Subsidiary in India)

(iii) Credit Capital Venture Fund (India) Ltd. (Joint Venture in India)

(iv) Bank Of India Shareholding Ltd. (Joint Venture in India)

(v) Bank Of India Nominees (Singapore) Ltd. (Subsidiary abroad)

(vi) Allied Bank Of Nigeria Ltd. (Associate abroad)

(vii) Indo Zambia Bank Ltd. (Associate Abroad)

SOURCES :

1. Indian Banking Year Book, 1997 Indian Banks' Association, Bombay

2. " BANKING LAW AND PRACTICE In India ," Tannan M.L. , Thacker & Co. 1971 Edition, Page 79

3. Bank Of India , Annual Report 1996-97

(viii) The Bank Of India (U.K.) Nominees Ltd. (Subsidiary abroad)

(ix) Bank Of India Mutual Fund (Mutual fund in India)

6.2 IMPORTANT INDICATORS OF BUSINESS GROWTH

We have analyzed in the subsequent paragraphs the important dimensions of business, growth and profitability of Bank Of India under various important heads viz. branch network, deposits, advances and its sectoral spread like industrial finance, priority sector lendings, diversification and new range of financial services, its international banking operations, total income, total expenses, interest spread, net profit and important financial ratios, computerisation and human resources etc.

6.2.1 Branch Network :

In March 1992, Bank Of India had 2,323 branches spread over different parts of India : out of which 55.7% branches were located in rural areas followed by 16.6% in semi-urban, 15.6% in urban and 12.1% in metropolitan centres. The position of branches of Bank Of India and other selected banks as at end-March 1992 and end-March 1997 is given in the following table :

*Selected Scheduled Commercial Banks branches in India : **

Position of Composition of Branches : Population Groupwise 4

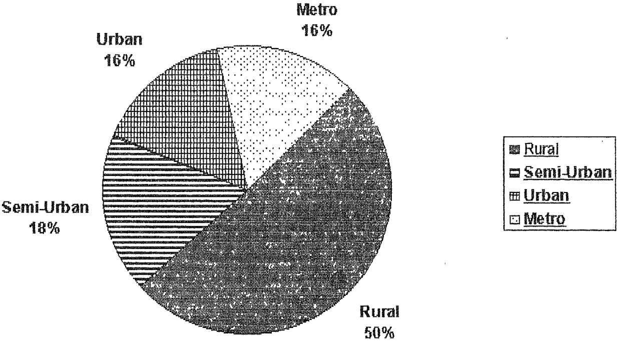
Bank Group	31 st March 1992					31st March 1997				
	Rural	Semi-urban	Urban	Metro	Total	Rural	Semi-Urban	Urban	Metro	Total
1. Bank Of India	1,293 (55.7)	387 (16.6)	362 (15.6)	281 (12.1)	2,323 (100)	1,251 (50.9)	431 (17.6)	386 (15.7)	388 (15.8)	2,456 (100)
2.State Bank of India	4,350 (50.7)	2,235 (26.0)	1,216 (14.2)	781 (9.1)	8,582 (100)	4,390 (49.7)	2,290 (25.9)	1,340 (15.2)	816 (9.2)	8,836 (100)
3. Oriental Bk.of Com.	249 (46.7)	94 (17.6)	113 (21.2)	77 (14.5)	533 (100)	246 (32.6)	228 (30.2)	185 (24.5)	96 (12.7)	755 (100)
4. Foreign Banks	-- --	1 (0.7)	16 (11.5)	122 (87.8)	139 (100)	-- --	-- --	30 (17.0)	146 (83.0)	176 (100)
5. Old Pv. Banks	1,409 (37.0)	1,095 (28.8)	830 (21.9)	468 (12.3)	3,802 (100)	1,415 (32.7)	1,332 (30.7)	998 (23.0)	589 (13.6)	4,334 (100)
6. New Pvt. Banks	-- --	-- --	-- --	-- --	-- --	-- --	18 (14.0)	44 (34.9)	66 (51.1)	128 (100)
7. Total Sch. Com Banks	21,683 (47.1)	10,364 (22.5)	8,107 (17.6)	5,859 (12.8)	46,013 (100)	21,497 (43.6)	11,596 (23.6)	9,262 (18.8)	6,912 (14.0)	49,267 (100)

(Figures in bracket are percentage to total)

The total number of branches increased from 2,323 in 1991-92 to 2,456 in 1996-97 registering a growth of 5.7% over a period of 5 years as against a growth rate of 2.9% for State Bank of India and 41.6% in respect of Oriental Bank Of Commerce. It shows that for banks with larger number of branches, this period has been more a period of consolidation rather than of expansion. Despite a decline in the percentage of rural branches from 55.7% in 1991-92 to 50.9% in 1996-97, BOI has the largest proportion of rural branches as compared to other banks stated above: SBI 49.7%, OBC 32.6% and Total Scheduled Commercial Banks 43.6%.

The share of rural, semi-urban, urban and metropolitan branches is ~~given~~ shown in the following pie-chart :

Bank Of India : Composition of Branches



The above pie-chart shows the composition of branches of Bank Of India and the largest share comprises of rural branches followed seriatim by semi-urban, metropolitan and urban branches.

SOURCES:

4. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97, IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 and 1996-97

Based on the criteria like excellence in customer service, ideal location, up-to-date house-keeping, effectiveness of marketing, quality of assets, business development etc., 205 branches of the Bank had been designated as " model " branches as at end-March 1992. 5

The Bank's thrust in branch expansion has been on opening more specialised branches in order to face successfully the emerging challenges and to carve out niche segments in diversified fields catering exclusively to the specific requirements of the customers. As at the year end 1996-97, the Bank had 58 specialised branches comprising of 25 SSI branches, 8 Corporate Banking Branches, 5 NRI branches, 3 High-Tech Agriculture Finance Branches, 7 Overseas Branches, 4 Capital Market Branches, 4 Recovery Branches, one each Leasing Finance and Housing Branch. The Bank opened 20 more branches in 1997-98 (7 metropolitan, 4 urban, 8 semi-urban and 1 rural branch). Out of these 20 branches, 13 are specialised branches (4 SSI branches, 2 High-Tech Agriculture Finance Branches, 5 Recovery Branches. and 2 Commercial & Personal Branches). Apart from these branches, there were 9 Overseas Centres and 1 NRI Centre to cater exclusively to overseas business of the Bank. Extension Counters were also opened primarily as deposit mobilising outlets. Total number of extension counters stood at 83 as at end-March 1997. The Bank has presence in all Time Zones through its 18 foreign branches and one representative office. Thus the total number of offices of the Bank stood at 2,495 in March 1998. 6

Branch expansion and changing scenario require reorganisation / restructuring. Implementation of the recommendations of various consultants appointed as a part of reorganisation exercise of Bank Of India have also been initiated in a phased manner. The Bank's vision is to become the " Bank of Choice for corporates, medium business and upmarket retail customers and to provide cost effective developmental banking for small business, mass market and rural markets. " Accordingly, the mission of the Bank is " to provide superior, proactive banking services to niche markets globally, while providing cost effective responsive services to others in our role as a development Bank and in so doing meet the requirements of our stakeholders. " 7 Towards these ends, the Bank has identified niche markets and accordingly detailed operational plans upto 2002 have been drawn with the professional assistance from experts.

6.2.2 Bank Domestic Deposits :

Deposits are important resources for the banks and represent a major item on the liabilities side. These are also one of the important parameters of growth. Deposits provide the resource for lendings and other profitable uses. Bank Of India has, therefore, attached significance to deposit mobilisation. The deposits of Bank Of India and two other selected banks i.e. State Bank Of India and Oriental Bank Of Commerce, foreign and private banks for the period 1991-92 to 1996-97 are given the following table :

SOURCES:

5. Bank Of India, Annual Report 1991-92

6 &7. Bank Of India Annual Report 1997-98

Domestic Deposits : Selected Banks / Bank - Groupwise Comparative position

(Amount Rs. in crore) 8

Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	Average% increase 1991-92 to 1992-97
Bank Of India	13,074	14,553	16,294	18,904	21,614	26,240	20.1
State Bank Of India	53,664	60,414	68,378	80,302	90,145	1,03,767	18.7
Oriental Bank Of Commerce	3,599	4,277	5,239	6,673	8,711	10,054	35.9
Old Private Banks	12,082	15,231	19,984	26,257	30,077	37,522	42.1
New Private Banks	--	--	--	--	5,937	13,092	24.1
Foreign Banks	16,898	20,875	25,897	28,034	30,632	37,394	24.3
Total Sch. Com. Banks	2,37,566	2,71,354	3,25,069	3,86,859	4,33,819	5,05,599	23.3

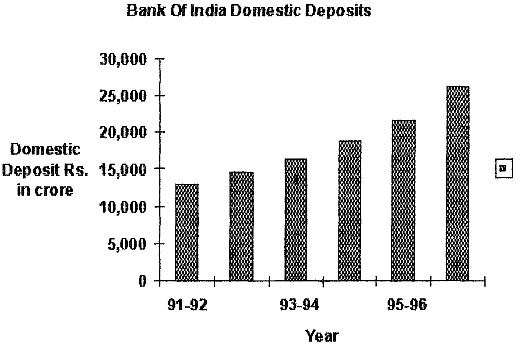
The domestic deposits of Bank Of India increased from Rs. 13,074 crore in 1991-92 to Rs. 26,240 crore in 1996-97 registering an average annual growth of 20.1% as compared to 18.7% achieved by State Bank Of India and 35.9% by Oriental Bank Of Commerce. The other Bank Groups recorded higher growth in deposits;highest average annual growth during the aforesaid period being 42.1% by Old Private Sector Banks, followed by foreign banks (24.3) and new private banks (who started their operations from 1995-96) increased their share by 24.1% but these categories of banks have comparatively smaller base and even a small absolute increase constitutes a higher percentage increase. Bank Of India launched two new deposit schemes in 1991-92 known as ' Star Suvidha ' and ' BOI Star ' targeting at customers having short term / medium term surpluses. The Bank introduced the ' Stockinvest ' scheme through 400 branches in 1992-93. BOI's aggregate deposits from domestic operations recorded a growth of 17.4%, in 1993-94,

SOURCES:

8. Indian Banks' Association Bulletin Vol. XIX No.3 , March 1997 (Special Issue on Customer Service in Banks) and performance Highlights of Banks 1996-97 , IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97.

which was higher than industry's growth rate of 16.2%. This rise in deposits was achieved despite shedding certificate deposits of Rs. 847 crore during the year as a cost reduction exercise. The better performance of the Bank in deposit mobilisation enabled it to improve its market share from 5.15% during 1992-93 to 5.20% during 1993-94 on outstanding basis. The Bank continued its thrust on rural publicity campaign through greater participation in welfare activities in the rural areas with the objective of mobilising rural savings. In 1994-95 bank deposits increased by 16%, in 1995-96 by 14% and highest being in 1996-97 i.e. by 21%. This could be possible by formulating , promoting and marketing various deposit schemes keeping in view the specific needs of the customers.

The deposit growth of Bank Of India during the aforesaid period has been shown by the following bar diagram :



Bar Diagram prepared on the basis of

Table given on the previous page

The above bar diagram shows a steady growth in the domestic deposits of Bank Of India from 1991-92 to 1996-97. It crossed Rs. 15,000 crore mark in 1993-94 , Rs. 20,000 crore mark in 1995-96 and Rs. 25,000 crore mark in 1996-97.

The foreign branches of Bank Of India have also made good contribution towards deposit

mobilisation as would be observed from the following data

Bank Of India : Foreign Deposits 9

Year	Amount of foreign deposits (Rs. in crore)
1991-92	6,136
1992-93	4,965
1993-94	5,126
1994-95	5,576
1995-96	5,909
1996-97	5,733
1997-98	7,970

During 1992-93, foreign branches in the wake of strong recessionary trends shedded their low yielding long term assets as also the costly borrowings in order to augment profitability. This led to shrinkage of overseas deposits by Rs. 1,171 crore during 1992-93 i.e. from Rs. 6136 crore in 1991-92 to Rs. 4,965 crore in 1992-93. The subdued growth in foreign deposits in 1993-94 was due to repayment of high cost borrowings in foreign operations at U.K., Singapore and New York in keeping with the Bank's policy to reduce high cost funds. The deposits of foreign branches of BOI increased by Rs. 2,237 crore in 1997-98 i.e. from Rs. 5,733 crore in March 1997 to Rs. 7,970 crore in March 1998; a growth of 39.02% during the year.

Reduced dependence on high cost market borrowings and 20.26% share of overseas deposits, where interest rates have been low, are the prime factors for reduction in cost of funds from 6.68% in 1996-97 to 6.29% in 1997-98. The cost of deposits has also come down from 7.50% to 6.92% over the same period. This is despite an increase in high cost term deposits from 63.91% as at March-end 1997 to 68.48% of global deposits in 1997-98. Reduction in minimum maturity to 30 days has led to the aforesaid shift from low cost savings and current deposits to high cost term deposits.

Thus in addition to large network of branches, enlargement of stable deposit base at rural and semi-urban areas, product innovation, customisation, introduction of new deposit schemes, publicity and marketing of deposit schemes blending the professional approach with active participation in various community activities under Rural Publicity Programme, deposits mobilised by foreign branches and that too at a lower cost and efficient product delivery have contributed to mobilisation of deposits. The Bank has

SOURCES:

9. Bank Of India , Annual Reports , 1991-92 to 1997-98

in place a system of review of the deposit schemes and the deposit schemes, which had failed to generate adequate response from the customers, were either discontinued or merged with other schemes. This helped in promotional efforts on products which have potential for business development.

The Bank also held special seminars in 1993-94 in collaboration with Indian Institute of Management, Bangalore and Management Development Institute, Gurgaon to acquaint and familiarise senior managers of the Bank with modern concepts of marketing for banking services. The marketing Department at Head Office was also computerised to expand the scope of activities particularly in the areas of market research and service, effective monitoring of promotional research vis-à-vis the resources.

6.2.2.1 Market Share in Total Deposits

The market share of selected banks / bank groups in 1991-92 and 1996-97 is given in the following table :

Market Share in Domestic Deposits:

Banks / Bank Groups 10

Banks / Bank Groups	1991-92 Market Share in %	1996-97 Market Share in %
Bank Of India	5.5	4.9
State Bank Of India	22.6	20.5
Associate Banks	6.2	7.4
19Nationalised Banks *	59.0	54.7
Old Private Banks	5.1	7.4
New Private Banks	--	2.6
Foreign Banks	7.1	7.4
All Total Sch. Com. Banks	100.0	100.0
Oriental Bank Of Commerce	1.5	2.0

* including Bank Of India and Oriental Bank Of Commerce

SOURCES:

10. Same as item No. 9

The market share of Bank Of India in domestic deposits declined from 5.5% in 1991-92 to 4.9% in 1996-97. The share of nationalised banks in the market also declined from 59% in 1991-92 to 54.7% in 1996-97. All other bank groups gained in the market share of domestic deposits e.g. associate banks of SBI from 6.2% to 7.4%, old private banks from 5.1% to 7.4% and foreign banks from 7.1% to 7.4% during the aforesaid period. As regards other two selected banks, State Bank Of India had a decline in the market share from 22.6% to 20.5% but Oriental Bank Of Commerce gained from 1.5% to 2% during the aforesaid period. The Bank should evolve suitable strategies to increase its market share of business.

6.2.2.2 Composition Of Deposits

The composition of demand and time deposits of the three selected banks in 1991-92 and 1996-97 is given in the following table :

Composition of Deposits : Demand and Time Deposits 11

Name of the Banks	1991-92 % of Demand to Total Deposits	1991-92 % of Time to Total Deposits	1996-97 % of Demand to Total Deposits	1996-97 % of Time to Total Deposits
Bank Of India	36	64	36	64
State Bank Of India	48	52	42	58
Oriental Bank Of Commerce	37	63	32	68
Total Scheduled Commercial Banks	35	65	34	66

Thus time deposits, which involve higher cost of funds have remained at the level of 64% of total deposits in case of Bank Of India during 1991-92 and 1996-97. In case of State Bank Of India, the proportion of time deposits to total deposits increased from 52% in 1991-92 to 58% in 1996-97 (still the lowest in the above group) and also in respect of Oriental Bank Of Commerce from 63% to 68%. For Bank Of India, the higher proportion of demand deposits than Oriental Bank Of Commerce and total scheduled commercial banks is a strong point. It is a favourable factor for increasing the interest spread and generation of higher profitability. With deregulation of interest rates on term deposits for more than 30 days and general trend of increasing proportion of time deposits, commercial banks have to meticulously determine interest rates to ensure economic viability of their operations and at the same time effectively meeting the

SOURCES :

11. Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for 1991 -92 and 1996-97 and IBA Bulletin Vol. XIX No. 3 March 1997 and Performance Highlights of Banks 1996-97.

competitive edge. Thus Bank Of India has maintained steady progress in (a) mobilisation of deposits, having nearly five percent share of the ASCB deposits in 1996-97, (b) by keeping control over the proportion of high cost time deposits, and (b) having a fairly stable domestic deposit base in rural and semi-urban areas, which constituted around 32% of the aggregate deposits of the Bank in 1997-98.

6.2.3 Bank Credit in India

Bank credit is a traditional banking function and is very crucial for banks for their profitability, efficient allocation of resources for maximising economic growth and also for meeting their obligations for the neglected sectors. For analysing this growth parameter, the aggregate bank credit in respect of Bank Of India and two other selected banks i.e. State Bank Of India and other bank groups are given in the following table:

Bank Of India : Advances in India

Comparative position in the Post-Reforms Period 12

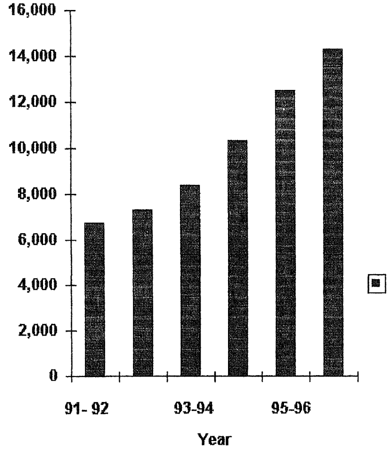
Banks / Bank Group	1991- 92	1992-93	1993-94	1994-95	1995-96	1996-97	Average % increase 1992-97
Bank Of India	6,767	7,327	8,372	10,330	12,531	14,363	21.0
State Bank Of India	29,854	38,300	37,532	41,214	51,813	55,023	16.9
Associate Banks	9,692	11,497	12,929	17,123	19,749	20,668	22.6
Nationalised Banks	73,678	83,852	82,695	1,02,983	1,17,380	1,25,915	14.2
Old Pvt. Banks	6,237	7,835	9,706	13,817	17,340	20,547	45.9
New Pvt. Banks	--	--	--	--	4,890	7,812	12.0
Foreign Banks	9,182	10,410	11,453	15,327	22,392	26,759	38.3
Total Sch. Com. Banks	1,28,643	1,51,894	1,54,315	1,90,464	2,33,564	2,56,724	19.9
Oriental Bank Of Commerce	1,763	2,219	2,567	3,529	4,672	4,886	35.4

SOURCES :

12. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97 , IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97 and Reserve Bank Of India Bulletin December 1997

Bank of India Advances in India

Period 1991-92 to 1996-97



The above diagram shows steady progress in advances in India by Bank Of India during 1991-92 to 1996-97. It crossed Rs. 10,000 crore mark in 1994-95 and was nearing Rs. 15,000 crore mark (Rs. 14,363 crore) in 1996-97.

At Rs. 6,767 crore, Bank Of India advances recorded a decline of Rs. 157 crore in 1991-92 in line with the policy of bringing about a better alignment between resources and deployment. Consistent with the

need to bring about a reduction in the dependence on costlier markets borrowings, their was a compression in the domestic credit portfolio. Following the policy of controlled credit expansion in 1992-93, there was an increase of 8.2% in domestic credit portfolio. In spite of the fact that a good number of corporate clientele preferred to rely on the capital market and on instruments like CPs for their fund requirements because of the prevalence of easy money market conditions, the Bank's net domestic credit increased by Rs. 945 crore or 12.7% to Rs. 8,372 crore in March 94; as compared the Industry's credit growth of 7.4%. With the revival of industrial activity and robust agricultural performance, the domestic credit expanded by 23.4% to Rs. 10,330 crore at end-March 1995. The Bank' credit expanded by 21.3% during 1995-96 reaching the level of Rs. 12,531 crore. The rise in non-food credit was of the order of 23.8%. The Bank's credit in its domestic operations increased to Rs. 14,363 crore in 1996-97. 13 Bank's net domestic credit further increased by 18.49% in 1997-98 reaching the level of Rs. 17,019 crore as on last Friday of March 1998.

The Bank has also enlarged its credit card business and recently issued 2,00,000th credit card and had a live card base of 1,83,702 cards with merchant base of 7,388 in 1997-98. The business turnover during the year was around Rs. 326 crore. The Bank is now directly connected with Master Card New York through VSAT, which enables the Bank to transfer the transaction data to Master card quickly and efficiently and to expeditiously claim the transaction amount. At present, the Bank have five affiliates and the Bank is providing various card related services to these affiliates.

6.2.3.1 Market Share in advances in India

Market share over a period of time is a good yardstick of judging whether the concerned bank / bank groups could maintain and accelerate the growth rate in comparison with the growth rate of their competitors. The new players like new private banks and addition to the number of foreign banks have made their market share mainly by slicing the share of public sector banks .

Market share in total advances in respect of Bank Of India increased from 5.1% in 1991-92 to 5.8% in 1996-97. The major loss took place in respect of nationalised banks, whose share declined from 58.2% to 47.6% during the aforesaid period. Inroads in their share have been made by the gains of Associate Banks of SBI from 7.4% to 8.3%, old private banks from 4.7% to 8.2%, new private banks from nil to 3.1% and foreign banks from 7% to 10.7%.

The market share of selected banks / bank groups in advances in India in 1991-92 and 1996-97 is given in the table given on the next page : 14

SOURCES :

13. Bank Of India , Annual Report 1996-97

14. Annual Reports of Bank Of India , State Bank Of India and Oriental Bank Of Commerce 1991-92 and 1996-97 and figures calculated on the basis of data contained in Performance Highlights of Banks 1996-97, Indian Banks' Association

Market Share in Advances in India

Banks / Bank Groups

Banks / Bank Groups	1991-92 Market Share in %	1996-97 Market Share in %
Bank Of India	5.1	5.8
State Bank Of India	22.7	22.1
Associate Banks	7.4	8.3
19 Nationalised Banks	58.2	47.6
Old Private Banks	4.7	8.2
New Private Banks	--	3.1
Foreign Banks	7.0	10.7
All Total Sch. Com. Banks	100.0	100.0
Oriental Bank Of Commerce	1.3	2.0

6.2.4 SECTORAL DEPLOYMENT OF CREDIT :

(a) *Industrial Finance :*

The non-food credit of Bank Of India increased from Rs. 7,029 crore in 1992-93 to Rs. 13,935 crore in March 1997; average annual increase of 32.9% during the four year period. The non-food credit further increased to Rs. 16,281 crore in March 1998 an increase of 16.8%. During the year 1997-98, Bank Of India made a major headway in term lending and prescribed a separate Prime Term Lending Rate (BOIPTLR) for the purpose. The Project Appraisal Division at the Corporate Office of the Bank garnered new term credit business. Primacy have been accorded to infrastructure projects and in tune with current national priorities, the aforesaid division has geared to meet the requirements of the emerging infrastructure development activities in the fields of oil, power, shipping, roads and telecom etc. The other major projects are textiles, oil refinery & allied activities, chemicals, steel and plastics / petrochem. The present exposure of the Bank in the infrastructure sector aggregates to over Rs. 800 crore. 15

SOURCES :

15. Bank Of India , Annual Report 1997-98

(b) *Priority Sector Lendings*

Priority sector lendings represent social aspect of lending. The amount of priority sector lendings and percentage to total bank credit by Bank Of India, State Bank Of India and Oriental Bank Of Commerce and other bank groups are given in the following table:

Priority Sector Lendings : Selected Banks / Bank - groupwise : Comparative position

(Rs. in crore) 16

Banks / Bank-Groups	1991-92 Amount	1991-92 % to total advances	1996-97 Amount	1996-97 % to total advances
Bank Of India	2,545	40	5,044	44
State Bank Of India	11,646	39	19,223	38
Public Sector Banks	43,573	38	79,131	42
Old Private Banks	1,798	28	6,074	43
New Private Banks	--	--	2,623	38
Foreign Banks	712	8	6,129	37
Oriental Bank Of Commerce	740	40	2,055	42

The priority sector lending of Bank Of India amounted to Rs. Rs. 2,545 crore with 18.7 lakh accounts at the end-March 1992 and accounted for around 40% of bank credit. The priority sector advances almost doubled to Rs. 5,044 crore accounting for 44.39% of net domestic bank credit at March-end 1997. Thus the BOI has exceeded the target of 40% of net bank credit set for priority sector lendings.

* *Advances to agriculture :*

The lendings to agriculture by Bank Of India during 1991-92 recorded an increase of Rs. 81 crore to reach the level of Rs. 1,178 crore during 1991-92 and covered over a million farmers. Direct finance to agriculture amounted to Rs. 1,032 crore. Financing of the farm sector covers wide range of developmental activities such as minor irrigation, farm mechanisation, horticultural development, tissue culture, fisheries, and poultries having good potential for income to the farmers. The Bank has also extended financial

SOURCES :
16. Same as item No 12

assistance to integrated projects involving hatchering, farming and processing of prawn culture. The Bank has also extended assistance to high-tech integrated milk processing unit capable of producing milk and milk products besides a variety of bi-products of milk. The Bank has also aided National Seed Production Programme. Agricultural advances of the Bank stood at Rs. 1,187 crore at March-end 1994. Greater emphasis has been placed on coverage of small and marginal farmer, landless labourers and sharecroppers in meeting their timely short-term production demands. The Bank is striving to achieve balanced credit expansion within its agricultural lending portfolio comprising of small and large farmers and corporate and high net worth individual borrowers diversifying into various agricultural and allied commercial activities. Bank's advances to agriculture registered an increase of 30.9% in 1996-97 thereby increasing agricultural lending from Rs. 1,600 crore at March-end 1996 to Rs. 2,094 crore at March-end 1997. The Bank opened one more hi-tech Agriculture Finance Branch during 1996-97 and two such branches in 1997-98. The agricultural advances as percentage of net credit of BOI has improved and reached a level of 18.90% and 19.06% to net domestic credit in 1996-97 and 1997-98 respectively ; thereby exceeding the RBI stipulated ratio of 18%.

Advances to agricultural sector by Bank Of India is given in the following table:

Advances to agricultural sector by Bank Of India 17

(Rs. in crore)

Year	Advances to agricultural sector
1991 - 92	1,178
1992-93	1,192
1993-94	1,187
1994-95	1,340
1995-96	1,600
1996-97	2,094

The Bank has lead responsibility in 41 districts covering eight zones spread over five states. Besides, the Bank has responsibility of convener bank for State Level Bankers' Committee (SLBC) in one state. The share of aggregate credit of the Bank under the district credit plan for the year 1996-97, in lead as well as non-lead districts, amounted to Rs. 365 crore and Rs. Rs. 608 crore respectively and for the Annual Credit Plans for the year 1997-98, it increased to Rs. 426.79 crore and Rs. Rs. 741.86 crore for the lead as well as non-lead districts respectively. The Bank's credit assistance through Self Help Groups (SHGs)

SOURCES:

17. Bank Of India , Annuals Reports 1991-92 to 1996-97

has shown good improvement and over 1,000 SHGs were under the Bank's fold by March-end 1998.

** *Advances to Small Scale Industries*

Small scale industries constitute another important area of priority sector lendings. The advances extended by Bank Of India to small scale industries stood at Rs. 887 crore in 1.13 lakh borrowal accounts at March-end 1992. The main focus of attention of the Bank in 1992-93 in SSI sector had been to maintain the steady growth of credit to this sector, to effect recovery of minimum Rs. 15 crore in the sticky suit filed /suit decreed SSI advances, to gear up efforts in respect of rehabilitation of sick units and ensure timely finalisation of viability studies and quick implementation of rehabilitation package for viable units and boost export finance to eligible SSI units as a part of enlarging credit to export sector. Advances to SSI units increased to Rs. 893 crore in 1992-93 and crossed Rs. 1000 crore mark (Rs. 1,128 crore) during 1993-94, recording an increase of 26.3%. The Bank also opened specialised branches for SSI units and number of specialised SSI branches was 5 and advances to SSI sector was Rs. 1,482 crore at March-end 1995; an increase of 31.4% over the previous year. The number of SSI branches further increased to 25 and advances to SSI sector got a boost and increased to Rs. 1,871 crore at March 1997; increase of 8% over the previous year..

The growth in advances to small scale industries provided by Bank Of India from 1991-92 to 1996-97 is given in the following table :

Advances to Small Scale Industries by Bank Of India 18

(Rs. in crore)

Year	Advances to Small Scale Industries
1991 - 92	887
1992-93	893
1993-94	1,128
1994-95	1,482
1995-96	1,731
1996-97	1,871

SOURCES:

18. Same as item No. 17

*** *Small Business Finance*

Advances to small business finance by Bank Of India is given in the following table:

Advances to Small Business Finance by Bank Of India 19

(Rs. in crore)

Year	Advances to Small Business Finance
1991 - 92	480
1992-93	464
1993-94	555
1994-95	664
1995-96	860
1996-97	1,079

In the tertiary sector, Bank Of India provides credit assistance to retail traders, transport operators, professionals and others with a view to creating self-employment opportunities. Bank's advances to such small business units stood at Rs.480 crore in 1991-92 but thereafter these advances registered a decline in 1992-93. Thereafter, such advances consistently increased and the increase was highest i.e. 29.5% in 1995-96 and 25.5% in 1996-97. Small Business Finance group advances amounted to Rs. 1,079 crore in 1996-97.

**** *Export Credit*

The export credit extended by Bank Of India amounted to Rs. 541 crore at year end 1991-92, comprising of pre-shipment credit of Rs. 275 crore and post-shipment credit of Rs. 266 crore. During the year 1992-93, the export credit of the Bank recorded 33.3% growth due to encouragement for boosting of exports particularly to post-shipment export credit denominated in foreign currency (PSCFC). The credit to the export sector reached the outstanding level of Rs. 740 crore or 9.9% of the Bank's net credit in India as against the national target of 10%. Six Overseas Branches and four Overseas Centres of the Bank serving exclusively to the specialised clientele of foreign exchange business also provide active support to the foreign exchange

SOURCES:

19. Bank Of India , Annuals Reports 1991-92 to 1996-97

business of the Bank. During the year ended March 1994, the exports and imports handled by the Bank increased by 35% and 50% respectively over the previous year. The Bank, equipped with adequate expertise and infrastructural facilities, had 148 branches actively involved in the foreign exchange business. The Bank's export credit further rose to Rs. 1,670 crore and Rs. 1,786 crore at March-end 1996 and 1997 respectively and constituted 12.43% of net credit at the year-end 1997 against the stipulated 12%.

Advances to exports by Bank Of India are given in the following table:

Export Finance by Bank Of India 20

(Rs. in crore)

Year	Advances to Small Business Finance
1991 - 92	541
1992-93	740
1993-94	977
1994-95	1,291
1995-96	1,670
1996-97	1,786

6.3 INTERNATIONAL BANKING OPERATIONS :

The Bank's international banking operations date back to 1946 when the first branch was opened in London. Currently international operations of the Bank consist of 19 foreign offices consisting of 18 branches and one Representative Office operating over four continents, with presence in all the major financial centres i.e. London, Paris, New York, Tokyo, Singapore and Hongkong. The Bank has two overseas Affiliates / Joint Ventures, two nominee companies and a finance company. The Bank also manages a Deposit taking company in Hongkong. The Bank has seven well equipped active dealing rooms at all major financial centres the world over covering all time zones. The Overseas operations of the Bank accounted for 21.76% of its total business during 1997-98. Operating profit of foreign operations of the Bank contributed 21.95% of its operating profit during 1997-98. The ratio of net non-performing assets of the foreign branches has also come down to 2.9% as at March-end 1998 as against 3.9% as at March-end 1997. Thus foreign operations of the Bank contribute significantly to the overall performance of the Bank. 21

SOURCES:

20 & 21. Bank Of India , Annuals Reports 1991-92 to 1996-97

6.4 CREDIT - DEPOSIT RATIO

Other factors having a bearing on profits are credit-deposit ratio as bank credit is still the highest earning asset of banks. The table containing credit deposit ratio of Bank Of India and other banks / bank groups is given below:

Credit - Deposit Ratio : Bank Groupwise : Comparative Position 22

Banks /Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Bank Of India	65.45	59.18	50.99	49.87	56.66	57.35
State Bank Of India	73.67	71.92	54.31	57.01	62.06	59.70
Associate Banks	61.04	59.60	52.10	57.50	57.56	55.57
Nationalised Banks	56.45	53.34	45.77	48.00	49.28	45.56
Old Private Banks	52.45	51.81	48.83	52.90	57.82	54.88
New Private Banks	--	--	--	--	82.33	59.67
Foreign Banks	54.42	49.98	44.32	54.84	73.68	71.57
All Sch. Com. Banks	60.35	57.54	48.13	54.70	58.60	55.10
Oriental Bank Of Commerce	48.99	51.89	49.00	52.88	53.63	48.60

It will be observed from the above that credit-deposit ratio in respect of public sector banks has declined, when data of 1991-92 is compared with the data of 1996-97. In case of Bank Of India also this ratio has declined mainly due to higher growth rate of deposits and comparatively slower increase in advances portfolio. A general decline in CD ratio in post-reforms phase witnessed in the portfolios of scheduled commercial banks is, inter alia, attributed to more cautious approach adopted by banks in the context of IRAC norms. But it is only a temporary phenomenon. CD ratio will increase as soon as industrial sector recovers.

The Credit-Deposit Ratio of Bank Of India at 65.45% was higher than the raio of 60.35% for

SOURCES:

22. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97 , IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97 and SBI Monthly Review April 1998 and Reserve Bank Of India Bulletin December 1997

all scheduled commercial banks but lower than SBI in March 1992. BOI Credit-deposit ratio started picking up from 1995-96 and was 57.35% in March 1997. This ratio is only marginally higher than the previous year and will pick up further when industrial sector growth picks up. In the present banking scenario, banks are providing finance to industries in various ways apart from pure credit. Therefore, it is more appropriate to include banks' investments in non-SLR securities of credit nature such as investments in corporate bonds and debentures etc. while calculating the Credit-Deposit ratio. Taking non-SLR investments of credit nature into account, the domestic Credit-Deposit Ratio of Bank Of India stood at 60.56% at March-end level 1998. 23

6.5 FUNDS MANAGEMENT AND INVESTMENT PORTFOLIO

The total investments of Bank Of India amounted to Rs. 5,260.78 crore at March-end 92 and increased to Rs. 7,295.38 crore and at March-end 1994. The judicious investment strategies increased gross interest income on the Bank's investments from Rs. 571 crore in 1992-93 to Rs. 649 crore in 1993-94. The yield on average investment increased marginally from 10.93% in 1992-93 to 10.96% in 1993-94. With the demand for credit picking up during 1994-95, the domestic investments showed a moderate increase of Rs. 748 crore during 1994-95. Bank's investment increased to Rs. 10,671 crore at end-March 1997, an increase of 11.37%. Average yield on investments (excluding special securities) increased from 11.50% in 1995-96 to 11.73% in 1996-97. The Bank's treasury operations have shown marked improvement during the year ended March 1997 and 71.45% of approved securities had been marked to market.

Investment in securities by Bank Of India from 1991-92 to 1996-97 are given in the following table:

Investment in securities by Bank Of India 24

(Rs. in crore)

Year	Investment in Securities
1991 - 92	5,261
1992-93	5,570
1993-94	7,295
1994-95	8,995
1995-96	9,584
1996-97	10,671

SOURCES:

23 & 24. Bank Of India , Annuals Reports 1991-92 to 1996-97

6.6 PROFITABILITY ANALYSIS

6.6.1 *Total Income*

Total income of Bank Of India, State Bank Of India and Oriental Bank Of Commerce and other bank groups from 1991-92 to 1996-97 are given in the following table :

Total Income : Banks / Bank Groupwise Distribution

| T O T A L I N C O M E | 25 | (amount in crore of rupees) |

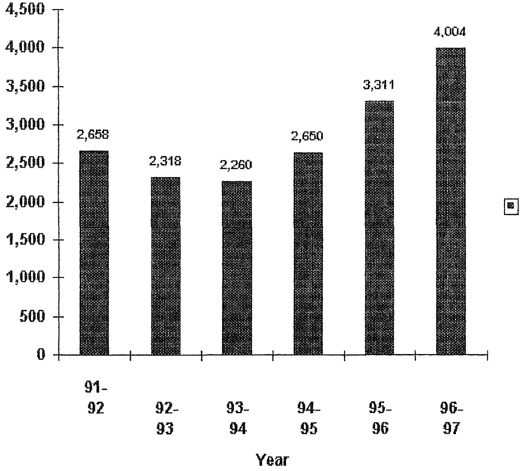
Bank Group / Banks	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	% average increase 1992-97
Bank Of India	2,658	2,318	2,260	2,650	3,311	4,004	10.2
State Bank Of India	10,931	11,157	10,746	12,250	15,716	17,594	12.2
Associate Banks	2,498	2,806	3,159	3,741	4,851	5,683	25.5
Nationalised Banks	20,734	21,881	23,406	27,241	33,075	37,994	16.6
Old Private Banks	1,521	1,881	2,366	3,220	4,285	5,360	50.4
New Private Banks	--	--	--	--	1,000	1,980	19.6
Foreign Banks	3,709	3,938	4,086	4,668	6,085	7,589	21.0
All Sch. Com. Banks	39,392	41,663	43,763	51,544	65,064	76,200	18.7
Oriental Bank Of Commerce	448	537	648	872	1,127	1,355	40.4

It will be observed from the above table that average total income of Bank Of India from 1991-92 to 1996-97 increased by 10.2%, which is the lowest percentage in above group. This is mainly due to decline

SOURCES:
25. Same as item No. 22

in total income of BOI in by 13% in 1992-93 and by 3% in 1993-94. The decline in total income of the Bank was both due to a decline in the interest income and non-interest income. Total income of the Bank increased from Rs. 2,260 crore in 1993-94 to Rs. 2,650 crore in 1994-95; an increase of 17.3%. It further significantly increased to Rs. 3,311 crore in 1995-96 and Rs. 4,004 crore in 1996-97 registering an increase of 24.9% and 21%respectively. 26

The growth / decline in total income of Bank Of India for the aforesaid period has been represented by the following bar-diagram:



Bar- Diagram Prepared on the basis of Table given on the previous table

The above diagram shows a decline in total income during 1992-93 and 1993-94 i.e. basically due to

SOURCES:

26. Bank Of India , Annuals Reports 1991-92 to 1996-97

IRAC norms and these issues have been examined in detail in subsequent paragraphs.

We shall further examine the break-up of income of Bank Of India into Interest Income and Non-Interest Income in the post-reforms period. The aforesaid data is given in the following table:

Bank Of India : Break-up of Total Income 27

Year	Interest Income	% of Interest Income to Total Income	Non-Interest Income	% of Non-Interest Income to Total Income
1991-92	2,363	88.9	295	11.1
1992-93	2,087	90.0	231	10.0
1993-94	1,988	88.0	272	12.0
1994-95	2,339	88.3	311	11.7
1995-96	2,890	87.3	421	12.7
1996-97	3,514	87.8	490	12.2
Average % increase during 1991-92 to 97-98	9.7%	--	13.2%	--

It is observed from the above table that while interest income of Bank Of India increased at an average rate of 9.7% during 1991-92 to 1996-97, its non-interest income increased at a faster rate of 13.2%. This shows that the Bank has actively explored other avenues of income like commission, exchange and brokerage business, profit on exchange transactions like remittances and income earned by way of dividend from subsidiaries and / or joint ventures in India / abroad. Interest income of the Bank has hovered around 88% except 1992-93 when it was 90%. Both the major components under interest income i.e. interest and discount on advances and bills and also income on investments have increased. While average interest and discount income on advances has increased by about 8.98% , average interest income from investments has increased at an average rate of 21.3% during the aforesaid period. The Bank is laying renewed emphasis on non-interest income as is evident from contingent liabilities / assets forming about 53.54% of assets at March-end 1998 as against 47.95% at March-end 1997. Non-interest income including exchange profit recorded a growth of 18.32% or 1.38% of average working funds during 1997-98. Major part of this

SOURCES:

27. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97 , IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97 and SBI Monthly Review April 1998 and Reserve Bank Of India Bulletin December 1997

increase from commission, exchange, brokerage and exchange transactions. Non-interest income comprised 31.10% of net income at March-end 1998 as against 30.07% as at March-end 1997.

6.6.2 Total Expenditure

Total expenditure is also a crucial factor in profits of the banks. The following table shows the total expenditure of Bank Of India and other selected banks / bank groups in the post-reforms period:

Total Expenditure : Banks / Bank Groupwise Distribution

| T O T A L E X P E N D I T U R E |28| (amount in crore of rupees)|

Banks/ Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	% increase 1992-97
Bank Of India	2,601	2,649	3,349	2,600	3,035	3,644	8.0
State Bank Of India	10,756	10,945	10,471	11,534	14,884	16,244	10.2
Associate Banks	2,427	2,738	3,078	3,610	4,890	5,362	24.2
Nationalised Banks	20,136	25,454	26,111	26,972	34,235	36,549	16.3
Old Private Banks	1,439	1,820	2,236	2,861	3,908	4,960	48.9
New Private Banks	--	--	--	--	830	1,701	21.0
Foreign Banks	3,319	4,838	3,582	4,037	5,396	6,923	21.7
All Sch. Com. Banks	38,077	45,795	47,478	49,438	64,203	71,760	17.7
Oriental Bank Of Commerce	421	517	616	759	954	1,175	35.8

The above table shows that average increase in expenditure of Bank Of India is 8% from 1991-92 to 1996-97, which is lowest among all the above banks / bank groups and it one of the important factors for profitability parameters. In fact during 1994-95, total expenditure of the Bank decreased from Rs. 3,349 crore in 1993-94 to Rs. 2,600 crore in 1994-95; an economy of 22.4%.

The break-up of total expenditure of Bank Of India is given in the following table so that various components thereof are analyzed :

Bank Cf India : Break-up of Total Expenditure 29

Year	Interest Expended	Operating Expenses	Provisions & contingencies	Total
1991-92	1,841	490	270	2,601
1992-93	1,665	545	439	2,649
1993-94	1,462	594	1,294	3,350
1994-95	1,558	775	266	2,599
1995-96	1,939	899	197	3,035
1996-97	2,373	1,051	220	3,644
Average % increase	5.8%	22.8%	*	8%

* Provisions and contingencies shot upto from Rs. 270 crore in March 1992 to Rs. 439 crore in March 1993 due to Income recognition and assets classification norms. It further increased to Rs. 1,294 crore in 1993-94 due to remaining 70% provisions made by the Bank as per the guidelines of Reserve Bank Of India on the prudential accounting practices. The operating expenses have increased faster @ average 22.8% p.a. from 1991-92 to 1996-97 as against average annual increase of 5.8% in interest expended during the same period. The main reason for the increase in operating expenses has been wage revision at the banking industry level in 1995. That is why highest increase in operating expenses @ 30.4% took place in 1994-95. With operating expenses and provisions and contingencies stabilising, the Bank will be in better position to contain expenses if the operating expenses are contained and loan portfolio is healthy.

SOURCES:

28. Same as item No. 27

29. Bank Of India , Annuals Reports 1991-92 to 1996-97

6.6.3 *Net Interest Income (Interest Spread) :*

The interest spread as percentage to total assets has witnessed an upward trend for Bank Of India during the post-reform phase except the set back in the initial year i.e. 1992-93 as would be observed from the following table:

Name of the Bank / Bank Group	Net interest income (Interest Spread) as % to Total Assets 30					
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Bank Of India	2.25	1.82	2.07	2.81	3.01	3.21
State Bank Of India	3.63	2.95	2.61	3.25	3.34	3.48
19Nationalised Banks	2.86	2.02	2.17	2.73	2.92	2.97
Total Public Sector Banks	3.22	2.39	2.36	2.92	3.08	3.16
25 Old Private Banks	4.02	2.91	2.97	3.04	3.14	2.96
9New Private Banks	--	--	--	1.17	2.84	2.91
39 Foreign Banks	3.92	3.56	4.21	4.24	3.74	4.09
Oriental Bank Of Commerce	4.29	2.83	3.29	3.81	3.80	3.89

It is observed from the above table that interest spread as percentage to total assets of Bank Of India has improved from 2.25% in 1991-92 to 2.81% in 1994-95. Net Interest income of Bank Of India increased to Rs. 1,140 crore during 1996-97 as compared to Rs. 952 crore in 1995-96, an increase of 19.75% over the previous year. As percentage to total assets, interest spread increased from 3.01% in March 1996 to 3.21% in March 1997. This is attributable to mainly to two factors; firstly, reduction in the ratio of net NPA to net advances and secondly, increase in yield on advances, which increased from 10.80% to 12.41%.

As compared to other banks, in 1996-97, ratio of net interest spread to total assets of BOI is higher than nationalised banks and public sector banks as a group and both the categories of private banks (old as

SOURCES:

30. Bank Of India , Annuals Reports 1991-92 to 1996-97

well as new). But it is lower than foreign banks, State Bank Of India and Oriental Bank Of Commerce. Foreign banks group have highest interest spread percentage to total assets for the obvious reason that they do not have obligations like low earning agricultural sector lendings and their non-performing assets are much lower. The percentage of interest spread to total assets is closely linked with yield on advances, which for BOI increased from 10.80% in 1994-95 to 13.17% in 1996-97.

6.7 NET PROFIT :

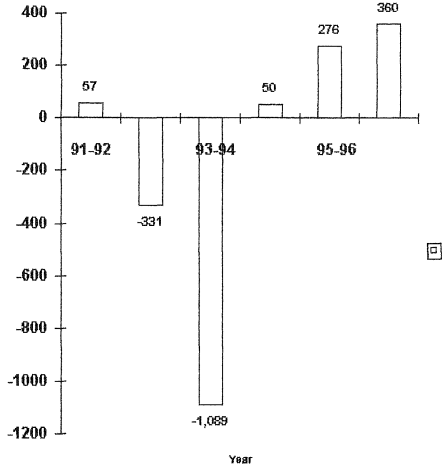
Consequent upon introduction of income recognition and provisioning norms, the provisioning requirements of Bank Of India shot up from Rs. Rs. 270.26 crore in 1991-92 to Rs. 439.12 crore in 1992-93. The Bank had also to exclude unrealised interest income of Rs. 99 crore during 1992-93. Consequently, BOI incurred net loss of Rs. 331.12 crore in 1992-93. During 1993-94, BOI made the remaining seventy percent provisions as per the guidelines of RBI on prudential accounting practices and the Bank's provisioning requirements shot up sharply to Rs. 1,293.95 crore ; an increase of 194.7% over the previous year. Consequently, the Bank's net loss further increased to Rs. 1,089.15 crore in 1993-94 thereby registering an increase of 228.9%, when nationalised banks as a group were also in red. The comparative position of net profits of the banks / bank groups is given in the following table:

Net Profit : Bank-Groupwise : Comparative Position 31

NET PROFITS (Rs. in crore)

Bank / Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	Average % increase 1991-92 to 1996-97
Bank Of India	57	-331	-1,089	50	276	360	21.3
State Bank Of India	175	212	275	715	832	1,329	26.4
Associate Banks	70	68	81	131	-38	356	16.3
Nationalised Banks	600	-3573	-4705	269	-1,161	1,445	5.6
Old Private Banks	81	61	130	359	377	400	15.8
New Private Banks	--	--	--	--	165	278	13.7
Foreign Banks	387	- 899	504	631	689	666	2.9
All Sch. Com. Banks	1,313	-4,131	-3,715	2,106	861		
Oriental Bank Of Commerce	27	21	32	113	173	180	22.7

Bank Of India was posted with a net profit of Rs. 50.35 crore in 1994-95 due to the turnaround strategy adopted by the Bank comprising of improved yield on assets portfolio, reduction of non-performing assets, mobilisation of low cost deposits and initiating cost effective measures. With further marked improvement in asset quality, reduction of NPA level and effective containment of operational expenses, in line with the commitments in the Memorandum of Undertaking (MOU) Of BOI to Reserve Bank Of India, the net profit of the Bank increased to Rs.276.48 crore in 1995-96, registering a rise of 452.% over the previous year. Net profit further increased to Rs. 360.02 crore in 1996-97, registering a healthy and encouraging increase of 30.2% over the previous year. The sustained and increasing net profits by BOI have been possible due to a planned strategy of raising low cost deposits, significant reduction in NPA levels and better assets-liabilities management.



Year

Bar - Diagram prepared on the basis of Table given on the previous page

SOURCES :

31. Report on Trend and Progress of Banking in India 1995-96 and 1996-97 (July-June) , Reserve Bank Of India

The above bar diagram shows net losses incurred by Bank Of India during 1992-93 and 1993-94 but they have considerably improved the position in the subsequent years specially 1995-96 and 1996-97.

6.8 NON - PERFORMING ASSETS

With the implementation of revised system of income recognition, asset classification and provisioning norms for bad debts on a prudential basis, the concept and treatment of non-performing assets in Bank Of India underwent complete transformation. The various measures taken by the Bank to contain NPAS include introduction of closely monitored recovery, Non-Performing Assets Reduction Budget, implementing nursing / rehabilitation programme in respect of potentially viable units and exploring all the possibilities for recovery including non-legal remedies like merger / amalgamation, sale of assets and even considering compromise proposals within Reserve Bank Of India norms both in suit and non-suit filed accounts, helped the Bank to contain the NPAs. The Bank also geared up its credit monitoring apparatus. The Bank carried out a detailed study of classification of large borrowal accounts and provision requirement for the year 1993-94. During the year a multi-pronged approach was adopted to contain the growing level of non-performing assets, on the one hand, and all out efforts were made, on the other hand, to recover non-performing assets so that interest income goes up and recycled funds start earning additional interest income. The system of allocating Zonewise recovery budget and monitoring performance thereagainst further contributed in improving the position of sub-standard and doubtful assets.

With the above measures, the Bank was able to reduce NPAs substantially and the ratio of NPA to total credit declined from 10.40% in March 1995 to 7% as at end March 1996 and further to 6.9% at March-end 1997. 32 The above position of BOI is better than State Bank Of India (7.30%) and Public Sector Banks (9.18%), but it is higher than private sector banks (5.99% for old private banks and 2.07% for new private banks) and foreign banks (2.50%). Net NPAs ratio of BOI have again risen to 7.34% in March 1998. In addition to the initiatives taken by the Bank, as mentioned above, the Bank has further strengthened its credit risk management in consonance with the change in operating environment consequent to economic reforms and globalisation of the Indian economy. Opening of Asset Recovery Branches, has facilitated focussed attention for faster recovery. However, sustained efforts are required to achieve international standard of less than 5% net NPAs to net advances.

6.9 FINANCIAL RATIOS

Financial ratios are important tools for examining efficiency of commercial organisations. The

SOURCES :

32. Bank Of India , Annual Report 1996-97

important financial ratios of Bank Of India, State Bank Of India and Oriental Bank Of Commerce, are given in the following table:

Financial Ratios : Comparative Data 33

Indicators as % to total assets	1991-92 Bank Of India	1991-92 State Bank Of India	1991-92 Oriental Bank of Commerce	1996-97 Bank Of India	1996-97 State Bank Of India	1996-97 Oriental Bank Of Commerce
Gross Profit	1.41	2.72	2.43	1.53	2.17	2.60
Net Profit	0.24	0.18	0.67	0.95	0.85	1.56
Interest Income	10.18	10.03	10.54	9.26	9.55	10.82
Interest Spread	2.92	3.63	4.29	3.00	3.43	3.89

Gross Profit as percentage to total assets of BOI has improved from 1.41% in March 1992 to 1.53% in March 1997 but it was highest for OBC among the selected banks in 1996-97 with Gross Profit Ratio of 2.60%. Net profit as percentage to total assets ratio of 0.95% of BOI is better than the SBI's ratio of 0.85% but lower than OBC 1.56 in March 1997. Interest income ratio of BOI has deteriorated and is also lowest among the selected 3 banks mainly due to compression of interest income on account of IRAC norms. Interest spread of SBI has improved but it has further scope for improvement by increasing yield on advances and mobilising low cost deposits.

The other financial ratios of SBI and other two selected banks in respect of expenses are also given in the following table:

Expense Ratios : Comparative Position of Selected Banks 34

Indicators as % to total assets	1991-92 Bank Of India	1991-92 State Bank Of India	1991-92 Oriental Bank of Commerce	1996-97 Bank Of India	1996-97 State Bank Of India	1996-97 Oriental Bank Of Commerce
Interest Expense	7.93	6.40	6.25	6.25	6.13	6.59
Provisions	1.16	2.54	1.76	0.58	1.32	1.04
Intermediation cost	2.11	2.37	2.53	2.77	2.94	2.19

SOURCES:

33 & 34. Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the respective years and also Report on Trend and Progress of Banking in India, 1996-97 (July-June), Reserve Bank Of India

Interest expense as percentage to total assets has increased for Bank Of India as percentage of time deposits to total deposits has been maintained at the same level but the position of SBI is best as regards low cost deposits. .Provisions as percentage to total assets has also improved for Bank Of India as the position of NPAs has improved and it is the lowest among the three banks. The Intermediation Cost Ratio has increased due to wage revision of employees in 1995 and OBC has the lowest ratio.

Improved earnings and profitability have a positive impact on the financial ratios. Return on assets and return on equity are linked with profits as percentage to assets and equity respectively. All these ratios have improved in respect of BOI as will be observed from the following table containing data in respect of BOI and other two selected banks:

Bank Groups / Banks : Financial Indicators : Comparative position 35

Indicators	1991-92 Bank Of India	1991-92 State Bank Of India	1991-92 Oriental Bank of Commerce	1996-97 Bank Of India	1996-97 State Bank Of India	1996-97 Oriental Bank Of Commerce
Return on assets %	0.243	0.185	0.670	1.01	0.880	1.56
Return on Equity %	8.49	11.97	23.49	18.57	16.77	19.14

The Return on Assets has improved in respect of Bank Of India from 0.243 in 1991-92 to 1.01 in 1996-97 and is higher than State Bank Of India but ROA of Oriental Bank Of Commerce has been higher both in 1991-92 and 1996-97. Return on Equity percentage has improved from 8.49% in 1991-92 to 18.57% in 1996-97. It is highest for Oriental Bank Of Commerce both in the years 1991-92 and 1996-97. The better performance of BOI has reflected in Earning Per Share (EPS) increasing from Rs. 0.26 in 1994-95 to Rs. 4.75 in 1995-96 and further to Rs. 6.03 in 1996-97.

6.10 PRODUCTIVITY RATIOS

Productivity ratios show the productivity of employees. The net profit per employee regarding

SOURCES:

35. State Bank Of India Annual Report 1991-92 to 1996-97 and Report on Trend and Progress of Banking in India 1996-97 (July - June), reserve Bank Of India

Bank Of India, SBI and OBC are given in the following table :

Net Profit Per-Employee (Amount in Rs.) 36

Banks	1 9 9 1 -92 Net Profit Per-Employee	1 9 96 -97 NetProfit Per-employee
Bank Of India	10,576	67,548
Oriental Bank Of Commerce	24,666	1,33,000
State Bank Of India	7,815	56,278

The Net Profit Per Employee has significantly improved in respect of BOI from Rs. 10,576 in 1991-92 to Rs. 67,548 in 1996-97. The Profit Per Employee was highest for Oriental Bank Of Commerce for the aforesaid period.

Deposits per employee and advances per employee in respect of the selected banks in the post reforms period is given in the following table :

Deposit Per-Employee & Advances Per Employee : Bank / Bank Groupwise : Comparative Position

(Rs. in lakh) 37

Banks / Bank-Groups	1 9 9 1 - 92 Deposit per-Employee	1 9 9 1 - 9 2 Advances per-employee	1 9 9 6 - 97 Deposit per-employee	1 9 9 6 - 9 7 Advances per-employee
Bank Of India	35.88	23.48	59.37	34.05
State Bank Of India	26.74	19.70	46.87	26.35
Associate Banks	20.16	12.31	45.30	25.17
Nationalised Banks	28.14	15.88	52.60	23.97
Old Private Banks	23.19	12.16	64.48	35.39
New Private Banks	--	--	532.83	317.95
Foreign Banks	128.74	70.06	268.73	192.32
Oriental Bank Of Commerce	33.15	16.24	74.04	35.98

SOURCES :

36. Annual Reports of State Bank Of India, Bank Of India and Oriental Bank Of commerce for the years 1991-92 and 1996-97

37. Reserve Bank Of India , Bulletin , December 1997 and Annual Reports of State Bank Of India, Bank Of India and Oriental Bank Of Commerce for the years 1991-92 and 1996-97

The deposits and advances per employee for Bank Of India have improved from Rs. 35.88 lac and Rs. 23.48 lac in 1991-92 to Rs. 59.37 lac and Rs. 34.05 lac respectively in 1996-97. It shows increasing productivity of the employees of BOI. Amongst the selected banks, performance of Oriental Bank Of Commerce was best. The deposits and advances per employee were highest in respect of new private banks followed by foreign banks in 1996-97 mainly due to their smaller set up and comparatively larger size of accounts.

6.11 CAPITAL ADEQUACY RATIO

During the year 1993-94, Bank Of India received Rs. 635 crore from the Government as a part of recapitalisation, increasing the total paid-up capital to Rs. 1,104 crore and total paid up capital and reserves amounted to Rs. 1,593 crore end-March 1994. BOI was permitted by Government Of India to set off its accumulated losses of Rs. 1,370 crore against its paid-up capital during 1995-96 and consequently the Bank's capital stood reduced to Rs. 582 crore as on 31 March 1996 but the Bank was able to maintain capital adequacy ratio of 8.44% as against the prescribed norm of 8%. During 1996-97, BOI raised capital of Rs. 150 crore through public issue. The Bank was able to acquire an investor base of 4.33 lakh shareholders. As a result, the Bank's tier I capital increased by Rs. 150 crore and with return of Rs. 93.47 crore to the Government, as part of capital restructuring, the Bank's paid-up capital and reserves improved to Rs. 1,939 crore at March-end 1997 and CAR stood at 10.26% as compared to 8.44% in the previous year.

The approach of Bank Of India to the capital adequacy standards has been prudent as would be observed from the following table, which shows the growth of Capital and Reserves of the Bank in the post-reforms period but due to setting off of net losses incurred, the position deteriorated in 1995-96. It has picked up in 1996-97 but the Bank has to take guard against recurrence of net losses so that viability of operations and CAR are maintained :

State Bank Of India : Capital & Reserves (Rs. Crore) 38

Year	Capital & Reserves	Percentage increase
1991-92	667	30%
1992-93	667	--
1993-94	1,593	139%
1994-95	2,426	52%
1995-96	1,260	- 48%
1996-97	1,939	54%

SOURCES :

38. Bank Of India , Annual Reports 1991-92 and 1996-97

6.12 CONTINGENT LIABILITIES

Contingent liabilities of Bank Of India amounted to Rs. 8639.86 crore in March 1992 representing 37.2% of total liabilities / assets of the Bank. Contingent liabilities increased to Rs. 18,194.23 crore in March 1997 accounting for 47.9% of total assets / liabilities of the Bank. Liabilities on account of outstanding forward exchange contracts, guarantees given on behalf of constituents in India and abroad and acceptances, endorsements and other obligations worked out to 92.7% of the total in March 1997. As such liabilities will have a rising trend due to increase in non-find based business, banks may evolve suitabe strategies to effectively manage such risks. 39

6.12 USE OF MODERN TECHNOLOGY

Foreseeing the need of computers in the Bank, Bank Of India was the first nationalised bank to open a fully computerised branch and instal an automated teller machine (ATM) in Mumbai way back in 1989. Following the computerisation agreement at the Industry level in October 1993, the Bank was on the threshold of a major technological thrust. The number of fully and partially computerised branches were 201 and 282 respectively in 1996-97; contributing about 60% of the Bank's business in India. Selected computerised branches were providing value added services like tele-banking and Remote Access Terminals. The Bank also operationalised 9 ATMs in Mumbai under the Shared Payment Network System. sponsored by Indian Banks' Association. 23 domestic branches and 6 foreign offices were connected to SWIFT by 1996-97 for providing better customer service. Besides, all 18 foreign branches and one representative of the Bank are using latest technology. To further advance the computerisation programme, the Bank undertook a training programme for creating a cadre of specialist officers in the area of information technology.

Bank Of India is also making a paradigm shift from branch automation to Bank automation. It is in the process of selecting a world class centralised application software package, which will facilitate networking 500 branches on, on-line real time basis. The Bank is also providing Electronic Funds Transfer Service at its 4 metro service branches for quick finds transfer. The Comprehensive Credit Information System (CCIS) and management information system (MIS) of the Bank are also fully automated.

Thus BOI is using computer and information technology judiciously at selected branches for value addition to the customers (by providing tele-banking facilities and facility of automated teller machines), providing electronic finds transfer by its 4 metro service branches, utilising it for centralised credit information system, training its staff to equip them with the required computer awareness and expertise and an ambitious planning for networking of its 500 branches. These strategies will be cost effective in the long run and are expected to promote profitability of the Bank.

SOURCES :

39. Bank Of India , Annual Report 1997-98

6.13 HUMAN RESOURCES DEVELOPMENT

Human resources management is of paramount importance in BOI to achieve excellent results. In order to gear up the human resources of the Bank to meet the challenges in the coming years, the Bank initiated certain measures like effective training to develop required skills, technological expertise and fast track promotions. The Bank is also endeavouring to redeploy the staff in the optimal way and at the same time retain the services of specialist officers to develop core competencies in the chosen fields.

In order to continuously upgrade the qualities and sharpen the skills of personnel, the training activities are organised by the Bank in multi-directional fashion viz. in-house training, training at national institutes of repute, training abroad and distant learning institute etc. Training colleges of the Bank have conducted new programmes like bullion banking, profit planning at branches, derivative products and foreign markets, modern techniques of auditing, relationship management with customers, integrated management of treasury and forex operations, project finance and corporate counselling and negotiation skills etc. In order to give an impetus and support to accelerated pace of computerisation in the Bank, a Manpower Support Plan and strategy for intensive training were also drawn up.

6.14 CUSTOMER SERVICE :

Customer service is the key area of Bank to improve and sustain business development for the Bank. As a part of educating the customers and also making the Bank's staff at all levels aware of the importance of customer service, the Bank organised Customer Rights Awareness Programmes at very large branches at Mumbai. The Bank has introduced the system of Customer Service Audit for ascertaining and assessing the quality of customer service at grass root level. The Bank has also embarked upon certain innovative steps such as appointing floor managers and setting up senior citizens' counters at some large branches for the convenience of elderly customers.

The Bank undertook a survey of branches across the country through a reputed market and research agency to assess and evaluate the level of customer satisfaction and service quality prevailing at the branches and also covered aspects of attitude and behaviour of staff members and implementation of core recommendations of Goipuria Committee. The Study was carried out in and around 17 cities spread across the country and 4,269 account holders were contacted among 100 branches of the Bank. The respondents were customers of the Bank for more than a year. The Survey revealed that 91% of the customers were satisfied with the overall process in the banking transactions, 60% of whom were reported to have expressed high satisfaction with BOI's services. Rating for manning of counters and courteous and helpful

nature of the staff was as high as 85% and 90% respectively. 40 The position relating to issuance of drafts and collection of upcountry instruments was also found to be as satisfactory. BOI had also identified complaint prone branches all over India so as to take corrective measures for improving services at these branches and move towards zero position of complaints. Besides, the reward and Recognition System for employees in customer service was also reviewed by the Bank in 1995-96 and a system of offering cash awards was introduced.

The Bank observed the year 1995-96 as the " Year of Customer "and 1996-97 as the " Year of Excellence ." The system of Customers Service Committees has been strengthened to facilitate and act as quality circles encompassing all aspects of improving branch functioning.

As a part of an ongoing exercise towards improvement in customer service and satisfaction, survey to another agency was entrusted specially to know the needs and perceived requirements of customers at metropolitan centres for focussing Bank's attention on them. The Agency observed that the customer service and overall level of customer satisfaction were comparable to competing leading banks and at times better than them. The ' unsatisfactory feedback ' was less by 3% than that of competing banks. The satisfaction indices at most of the branches were laudable.

A comprehensive action plan was embarked upon by BOI at metro and urban branches for sustainable improvement in customer service areas like collection of upcountry as well as local instruments, issuance of demand drafts, pay orders, nomination facility, updating of pass books and statements of accounts. With a view to further boosting the customer service drive, an in-house exercise on customer service evaluation and ratings on branches on customer service has been started by the Bank from November 1996. Branches rate themselves on various customer services in numerical terms based on the opinions of cross-section of their customers. This gives an impetus to branches in providing better and effective customer service. The Reward and Recognition Scheme started by the Bank since 1995 has created much needed awareness amongst the staff members about their concern and commitment to customer service.

6.14 CONCLUSION

Thus Bank Of India is strongly placed and has strong fundamentals in many facets of banking. It has a wide network of 2,495 branches spread all over India and in all major financial centres of the world servicing about 20 million customers. In order to cater to the specialised requirements of its diversified group of customer, the Bank has identified lines of business viz. Corporate Banking, Commercial & Personal Banking, Retail Banking and Rural & Development Banking.. The Bank has accordingly designed products

SOURCES :

40. Same as 39

and services keeping in view the requirements of various segments of customers. The Bank has also identified specialised target groups to develop core advantages and opened specialised branches to cater to their requirements. At March-end 1998, the Bank had 79 specialised branches.

With the growth in domestic deposits of BOI crossing Rs. 26,000 crore mark (Rs. 26,240 crore) in March 1997, the Bank has requisite funds to deploy in profitable business. But as cost of deposits has increased from 6.47% in March 1995 to 7.50% in March 1997, the Bank will have to plan for mobilisation of low cost deposits. The Bank's advances in India recorded average annual growth of 21% during March 1992 - March 1997 and have reached the level of Rs. 14,363 crore as at March-end 1997. The yield on advances has increased from 10.80% in March 1995 to 13.17% in March 1997 and the Bank will have to ensure that it is adopting appropriate policy for determining its interest rates (both deposit rates as well as lending rates) in the partially deregulated set up so that its viability is not affected and at the same time its pricing is competitive.

The Bank has entered the segment of term finance / project finance in a significant way. A Project Appraisal Division of the Bank is geared to meet the requirements of, inter alia, the emerging infrastructure activities in the fields of oil, power, shipping, roads, telecom etc. Bank Of India with its presence in all major financial centres of the world is in a position to benefit from the integration of domestic and foreign markets. In order to meet the challenges of an evolving market, BOI has integrated its domestic and foreign treasury operations and has opened a fully integrated Treasury Branch. The Treasury, as convenor to the Asset-Liability Committee meetings, is also paying special attention to risks arising out of maturity and interest rate mismatches.

Bank Of India is also alive to its social commitments and has fulfilled the targets for priority sector lendings. By the end of March 1997, the Bank had extended 44% of its net credit to the priority sector comprising of agriculture, small scale industries, small business finance, transport operators and weaker sections of the society. It has also opened Hi-Tech Agriculture Finance branches and SSI branches for effectively meeting the credit requirements of these sectors.

The Bank has completed nearly a decade in credit card business known as ' India Card '. Credit card is the money of future. The thrust on this business, besides being profitable due to growing consumerism, also provides an opportunity for increasing the customer base of the bank and thereby enhancing business opportunities.

After incurring heavy net loss amounting to Rs. 1,089 crore in 1993-94, the Bank made a turnaround and made net profit of Rs. 50 crore in 1994-95 increasing to Rs. 360 crore in 1996-97 by evolving suitable

strategies like increasing return on advances and exercising effective control on non-performing assets. With improving profitability, return on assets has improved from 0.18% in March 1996 to 1.01% in March 1997. Assets utilisation factor (Ratio of total income to total assets) has also improved from 1.14% to 1.63% during the aforesaid period. The Intermediation Expenses Ratio of BOI is higher than SBI, OBC and all scheduled commercial banks. The Bank will have to contain the controllable expenses so that optimum level of profitability is maintained. Increasing productivity of the employees reflected by deposits, advances and profit per employee is a good indicator of efficiency.

The Bank has also been a forerunner in adopting technology for giving better quality of services to its customers. At March 1998, the Bank had 495 computerised branches and 5 computerised clusters. Besides, all 18 foreign branches of the Bank and one representative office are using latest technology. Going further ahead, the Bank is making paradigm shift from branch automation to Bank automation. It is in the process of selecting a world class Centralised application software package, which will facilitate networking of 500 branches on, on-line real time basis. This will enable its selected customers to access their accounts from any of its networked branches, apart from further improving the effectiveness of Management Information Systems, Executive Information Systems, Risk Management and Asset Liability Management. The Bank is also a member of the VSAT based Wide Area Network being established by Reserve Bank Of India. With the introduction of technology, the Bank is extending services like Tele-banking with Fax-on-Demand in 100 branches. The Bank is also providing Electronic Funds Transfer (EFT) service at its 4 Metro service branches for quick funds transfer. The Bank's Website http.\ www. expressindia. com is the latest addition to the Bank's long list of technological absorption.

Proactively, the Bank has initiated re-engineering of various processes to gain an edge in the competitive environment. A customised package taking care of all aspects from credit appraisal, sanction and monitoring is being developed for Bank Of India, to automate the whole procedure for speedier credit delivery. This alongwith liberal delegation of powers, organisational restructuring and rationalising various administrative layers will enable faster disposal of proposals. The Bank has also taken steps to strengthen communications by networking major Indian branches under its project BOINET and is also installing a fully automated management information system., so as to build up creditable database with real time updating.

The Bank is alive to the emerging opportunities and has diversified into new profitable business. It was one of the seven banks authorised by Reserve Bank Of India in August 1997 to import gold, silver and platinum for sale to exporters, visiting NRIs, special import license holders and domestic users. The Bank has increased its stake in Securities Trading Corporation of India (STCI), the largest primary dealer to 28.37% thereby becoming its largest shareholder. STCI is profit making dividend paying company.

The Bank's capital adequacy ratio has also improved to 10.26% in March 1997 as compared to 9.10% in March 1995. The Bank has to maintain a reasonable CAR well above the prescribed minimum. The best way to have a better Capital to Risk Weighted Assets Ratio (CRAR) is to properly control the risk-weighted assets by maintaining proper balance between risk and yield. It will also help in controlling non-performing assets. The bank has already strengthened its credit risk management with the change in the operating environment. It will also help in containing provisions and contingencies for bad and doubtful debts, which is drain on profit.

The Bank has been one of the early organisations to constitute Asset-Liability Management Committee (ALCO) to analyse the maturity profiles, interest rate sensitivity and gap analysis of the Bank's assets and liabilities and to review product pricing in the light of emerging environmental factors within the banking sector.

Deregulation and liberalisation provide good opportunities for business growth and profits but at the same time pose great challenges to Bank. Greatest challenge will be forthcoming from foreign banks and also new private sector banks. As Bank Of India has been loser in terms of its market share of deposits from 5.5% in March 1992 to 4.9% in March 1997, it have to properly scan the environmental factors and devise suitable strategies comprising of efficient customer service, product development and marketing techniques. It will have to be monitored that computer application generates value-added services, reduces cost and enhances productivity and profitability of the Bank. A good feature for Bank Of India is that it has gained in terms of its market share of advances from 5.1% in March 1992 to 5.8% in March 1998.

The overall position of selected financial parameters, key business variables, asset-liability management ratios, customer service, human factors and application of computers and information technology give a good prospect for future to Bank Of India, but it will be full of challenges due to deregulation, liberalisation and stiff competition.

CHAPTER VII

ORIENTAL BANK OF COMMERCE : A PROFILE

CHAPTER VII

ORIENTAL BANK OF COMMERCE

7.1 INTRODUCTION

Oriental Bank Of Commerce was established at Lahore on February 19, 1943. After partition, it moved its registered office from Lahore to Amritsar. In 1951, the Registered Office of the Bank was again shifted from Amritsar to Delhi. The Bank made an humble start and by the end of the year 1976, it had a network of 211 branches with deposits and advances at Rs. 108.62 crore and Rs. 63.81 crore respectively. 1 It was nationalised on 15th April 1980, when it had a network of 307 branches with deposits to the extent of Rs. 282.61 crore and advances Rs. 152.69 crore. Thereafter, the Bank has made significant progress in all the facets of banking : branch expansion, deposit mobilisation, lendings to different segments including the priority sector lendings, improving total income : both interest and non-interest income, containing expenses, increasing net profits and improving profitability and efficiency ratios.

Oriental Bank Of Commerce has a three tier organisational structure viz. Head office as the apex, Regional Offices as the intermediaries and branches at the grass root level. The aforesaid structure is considered sufficient at present for exercising effective control and the required lead for future progress. But when the Bank expands further, it may consider adding one more tier so that the Controller's office is located near the operating level.

7.2 IMPORTANT INDICATORS OF BUSINESS GROWTH

We have analysed in this Chapter the important dimensions of business, growth and profitability of Oriental Bank Of Commerce under various heads viz. branch network, deposits, advances and its sectoral spread like priority sector lendings, diversification and new range of financial services, foreign exchange operations handled by its branches in India, total income, total expenses, interest spread, net profit and important financial ratios, computerisation, customer service and human resources etc.

7.2.1 Branch Network

The progress of branch expansion of Oriental Bank Of Commerce since inception to 31st March 1998

SOURCES:

1. **Oriental Bank Of Commerce , Annual Report 1994-95**

is given in the following table: 2

Oriental Bank Of Commerce : Branch Expansion

Year	Branch Expansion
1943	1st
1973	100th
1976	200th
1979	300th
1983	400th
1988-89	500th
1994-95	600th
1995-96	700th
1997-98	800th

It is observed from the above table that initially it took 30 years to Oriental Bank Of Commerce to open 100th branch in 1973 but branch expansion has been faster after its nationalisation in 1980. The comparative position of branches of OBC, other 2 selected banks and bank groups is given in the following table:

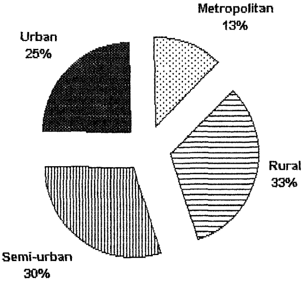
Oriental Bank Of Commerce : Branch Network : Comparative Position 3

Bank Group	31st March 1992					31st March 1997				
	Rural	Semi-urban	Urban	Metro	Total	Rural	Semi-Urban	Urban	Metro	Total
1. Oriental Bk. of Com.	249 (46.7)	94 (17.6)	113 (21.2)	77 (14.5)	533 (100)	246 (32.6)	228 (30.2)	185 (24.5)	96 (12.7)	755 (100)
2. State Bank of India	4,350 (50.7)	2,235 (26.0)	1,216 (14.2)	781 (9.1)	8,582 (100)	4,390 (49.7)	2,290 (25.9)	1,340 (15.2)	816 (9.2)	8,836 (100)
3. Bank Of India	1,293 (55.7)	387 (16.6)	362 (15.6)	281 (12.1)	2,323 (100)	1,251 (50.9)	431 (17.6)	386 (15.7)	388 (15.8)	2,456 (100)
4. Foreign Banks	-- --	1 (0.7)	16 (11.5)	122 (87.8)	139 (100)	-- --	-- --	30 (17.0)	146 (83.0)	176 (100)
5. Old Pvt. Banks	1,409 (37.0)	1,095 (28.8)	830 (21.9)	468 (12.3)	3,802 (100)	1,415 (32.7)	1,332 (30.7)	998 (23.0)	589 (13.6)	4,334 (100)
6. New Pvt. Banks	-- --	-- --	-- --	-- --	-- --	-- --	18 (14.0)	44 (34.9)	66 (51.1)	128 (100)
7. Total Sch. Com. Banks	21,683 (47.1)	10,364 (22.5)	8,107 (17.6)	5,859 (12.8)	46,013 (100)	21,497 (43.6)	11,596 (23.6)	9,262 (18.8)	6,912 (14.0)	49,267 (100)

Total number of branches of Oriental Bank Commerce increased from 533 in March-end 1992 to 755 at March-end 1997; an increase of 41.6% over a period of five years as compared to 2.9% in case of State Bank Of India, 5.7% in case of Bank Of India and 14% in respect of Old Private Banks. This is the advantage of being a comparatively small bank in case of Oriental Bank Of Commerce. While percentage of rural branches to total branches declined from 46.7% to 32.6% during the aforesaid period, the percentage of semi-urban branches registered an increase from 17.6% to 30.2%, which is only next to old private banks (30.7%) during the period stated above.

The break-up of branches of Oreintal Bank Of Commerce in March 1997 is depicted by the following pie-chart:

Oriental Bank Of Commerce : Branch Network Classification



Pie-Chart Diagram prepared on the basis of the table given on the previous page

Oriental Bank Of Commerce also has 80 Extension Counters functioning in various institutions in different states. The Bank also opened Specialised Branches and the number of such branches was 22 as on 31.3.1997; which comprised of 6 Overseas Branches, 2 Industrial Finance branches and 14 SSI Branches

SOURCES:

2. Indian Banks' Association Bulletin, Volume XX No. 3, March 1998

3. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97, IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 and 1996-97.

for providing focussed attention to the specific target-segment of the customers. The Bank crossed an imortant milestone by opening its 800th branch in 1997-98, which is the first Corporate Branch of the Bank and, with the use of state-of-the-art technology including inter-net, SWIFT and telebanking, it provides on-line facilities to its corporate borrowers. The total number of branches of OBC increased to 841 at March-end 1998; an increase of 11.4%. The number of extension counters and satellite offices as on 31.3.1998 stood at 77 and 7 respectively 4 for providing banking services near the work-place of the customers.

It is, no doubt, true that branch expansion is an important indicator of growth but what is more important is its viability and as such viability study of the proposed branch in the light of business potential must be conducted before opening the branch.

7.2.2 Bank Domestic Deposits

The comparative position of deposits of the selected banks is given in the following table :

Domestic Deposits : Banks / Bank-Groupwise Comparative position (Amount Rs. in crore) 5

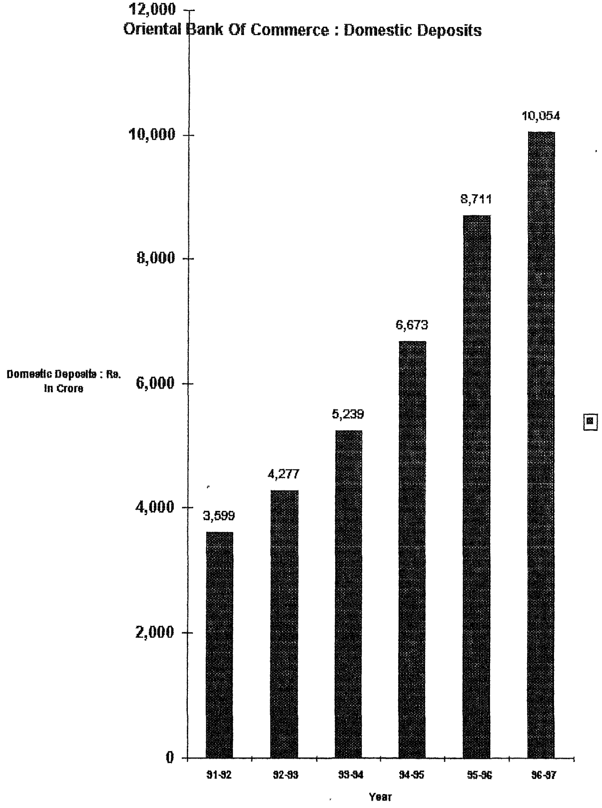
Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	Average% increase 1991-92 to 1992-97
Oriental Bank Of Commerce	3,599	4,277	5,239	6,673	8,711	10,054	35.9
State Bank Of India	53,664	60,414	68,378	80,302	90,145	1,03,767	18.7
Bank Of India	13,074	14,553	16,294	18,904	21,614	26,240	20.1
Old Private Banks	12,082	15,231	19,984	26,257	30,077	37,522	42.1
New Private Banks	--	--	--	--	5,937	13,092	24.1
Foreign Banks	16,898	20,875	25,897	28,034	30,632	37,394	24.3

SOURCES:

4. Oriental Bank Of Commerce , Annual Report 1997-98

5. Same as for item No. 3

The growth of domestic deposits of Oriental Bank Of Commerce is depicted by the following bar diagram:



The above bar-diagram shows consistent growth in domestic deposits of Oriental Bank Of Commerce. Total deposits of Oriental Bank Of Commerce increased from Rs. 3,599 crore in 1991-92 to Rs. 10,054 crore in 1996-97; thereby registering an average annual increase of 35.9% higher than State Bank Of India (18.7) and Bank of India (20.1%). The growth of deposits of OBC was even higher than foreign banks (24.3%) and new private banks (24.1%). Only old private banks had a higher growth of deposits i.e. 42.1%. It was due to new deposit schemes and tremendous marketing effort by the Bank and in the process it crossed the 10,000 crore mark in deposits. During 1997-98, OBC again had a spectacular growth in deposits taking total deposits to Rs. 13,058 crore in March-end 1998. It works out to 29.9%, which is much higher than 18.9% growth in deposit recorded by the banking industry.

7.2.2.1 Market Share in Total Deposits

The market share of selected banks / bank groups in 1991-92 and 1996-97 is given in the following table :

Market Share in Domestic Deposits:

Banks / Bank Groups 6

Banks / Bank Groups	1991-92 Market Share in %	1996-97 Market Share in %
Oriental Bank Of Commerce	1.5	2.0
Bank Of India	5.5	4.9
State Bank Of India	22.6	20.5
Associate Banks	6.2	7.4
19Nationalised Banks	59.0	54.7
Old Private Banks	5.1	7.4
New Private Banks	--	2.6
Foreign Banks	7.1	7.4
All Total Sch. Com. Banks	100.0	100.0

SOURCES:

6. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97, IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 and 1996-97.

The market share of Oriental Bank Of Commerce in domestic deposits improved from 1.5% in 1991-92 to 2% in 1996-97. The losers in the market share have been several public sector banks including SBI and BOI. The gainers in the market share are Associate of State Bank Of India (from 6.2% to 7.4%), foreign banks (from 7.1% to 7.4%) and old private banks (from 5.1% to 7.4%). Vigorous marketing, product development and excellent customer service are the key to success for OBC.

7.2.2.2 *Composition Of Deposits*

The composition of demand and time deposits of the three selected banks and total scheduled commercial banks in 1991-92 and 1996-97 is given in the following table :

Composition of Deposits : Demand and Time Deposits 7

Comparative Position of Selected Scheduled Commercial Banks

Name of the Banks	1991-92 % of Demand to Total Deposits	1991-92 % of Time to Total Deposits	1996-97 % of Demand to Total Deposits	1996-97 % of Time to Total Deposits
Oriental Bank Of Commerce	37	63	32	68
Bank Of India	36	64	36	64
State Bank Of India	48	52	42	58
Total Scheduled Commercial Banks	35	65	34	66

Thus time deposits as percentage of total deposits of Oriental Bank Of Commerce, which involve higher cost of finds, increased from 63% in 1991-92 to 68% in 1996-97 as a consequence thereof the cost of deposits increased from 6.5% to 7.8% during the above period. In case of State Bank Of India, the proportion of time deposits to total deposits increased from 52% in 1991-92 to 58% in 1996-97 (still lowest in the above group) and in respect of Bank Of India it remained at the same level of 64%. For Oriental Bank Of Commerce, the higher proportion of time deposits than Bank Of India, State Bank Of India and total scheduled commercial banks is an unfavourable factor, which OBC must examine. With deregulation of interest rates on term deposits for more than 30 days and general trend of increasing proportion of time

SOURCES :

7. Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for 1991 -92 and 1996- and IBA Bulletin Vol. XIX No. 3 March 1997 and Performance Highlights of Banks 1996-97.

deposits, commercial banks have to devise suitable mechanism to determine interest rates to ensure profitability of their operations and at the same time meet the competition.

Thus OBC has made steady progress in mobilisation of domestic deposits but it must explore the avenues of tapping greater share of demand deposits, which are low cost deposits.

7.2.3 BANK CREDIT

Total Bank credit of Oriental Bank of Commerce increased from Rs. 223.64 crore at December-end 1981 to Rs. 1203.07 crore at March-end 1990 ; an average annual growth of 48.6%. The Bank's total advances further increased to Rs. 1,763.27 crore in March 1992; an annual increase of 23.3%. The comparative position of total bank credit extended by Oriental Bank Of Commerce and other selected banks / bank groups is given in the following table :

Oriental Bank Of commerce & other banks / bank groups Advances in India

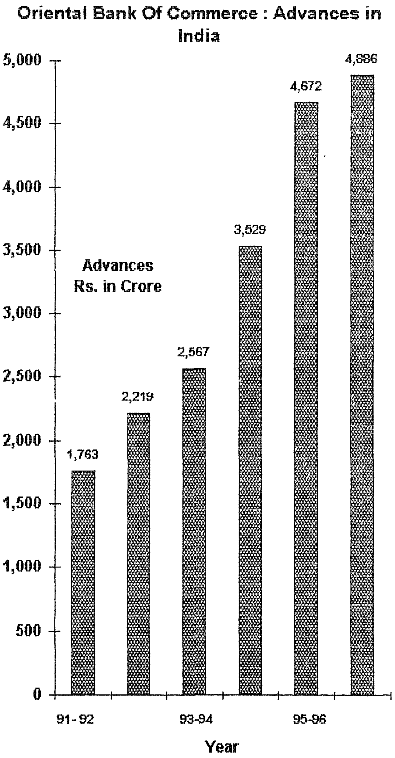
Comparative position of Selected Banks in the Post-Reforms Period 8

Banks / Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	Average % increase 1992-97
Oriental Bank Of Commerce	1,763	2,219	2,567	3,529	4,672	4,886	35.4
State Bank Of India	29,854	38,300	37,532	41,214	51,813	55,023	16.9
Bank Of India	6,767	7,327	8,372	10,330	12,531	14,363	21.0
Nationalised Banks	73,678	83,852	82,695	1,02,983	1,17,380	1,25,915	14.2
Old Pvt. Banks	6,237	7,835	9,706	13,817	17,340	20,547	45.9
New Pvt. Banks	--	--	--	--	4,890	7,812	12.0
Foreign Banks	9,182	10,410	11,453	15,327	22,392	26,759	38.3
Total Sch. Com. Banks	1,28,643	1,51,894	1,54,315	1,90,464	2,33,564	2,56,724	19.9

SOURCES:

8. Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 and 1996-97 and Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97, IBA publication.

The advances in India extended by Oriental Bank Of Commerce from 1991-92 to 1996-97 are represented in the following bar diagram :



Bar Diagram prepared on the basis of the Table given on the previous page

Total advances of OBC increased from Rs. 1763 crore in March 1992 to Rs. 4,886 crore in March 1997 representing an average annual growth of 35.4%, highest as compared to State Bank Of India and Bank Of India, which had annual growth rate of advances 16.9% and 20.1% respectively. Only old private banks and foreign banks had higher increase of 45.9% and 38.3% respectively. Total advances of OBC had a phenomenal growth in 1997-98 i.e. Rs. 1432.04 taking total advances to Rs. 6,318.46 crore in March 1998 thereby registering an increase of 29.3% as compared to growth of 19.3% and 19.7% in respect of State Bank Of India and Bank Of India respectively during 1997-98. The increase in advances of OBC has taken place under all the heads i.e. priority sector, public sector, banks and others. While term loans have increased from Rs. 603.58 crore at March-end 1992 to Rs. 1805.56 crore in 1997-98, the proportion of term loans to total loans has marginally decreased from 29.7% of total bank credit to 28.6%.

7.2.3.1 Market Share in advances in India

Market share is an indicator of competitive position of the organisation in the market. The comparative position of the selected banks and other bank groups is given in the following table:

Market Share in Advances in India

Selected Banks / Bank Groups 9

Banks / Bank Groups	1991-92 Market Share in %	1996-97 Market Share in %
Oriental Bank Of Commerce	1.3	2.0
Bank Of India	5.1	5.8
State Bank Of India	22.7	22.1
Associate Banks	7.4	8.3
19 Nationalised Banks	58.2	47.6
Old Private Banks	4.7	8.2
New Private Banks	--	3.1
Foreign Banks	7.0	10.7
Total Sch. Com. Banks	100.0	100.0

Market share in total advances in respect of Oriental Bank Of Commerce increased from 1.3% in 1991-92 to 2% in 1996-97. But the share of nationalised banks as group declined from 58.2% to 47.6% during the aforesaid period. Inroads in their share have been made by the gains of Associate Banks of SBI

SOURCES :

9. Same as for item No. 8

from 7.4% to 8.3%, old private banks from 4.7% to 8.2%, new private banks from nil to 3.1% and foreign banks from 7% to 10.7%. As regards other two other selected banks, while Bank Of India marginally gained, State Bank Of India marginally lost in their market share.

Scanning the environmental data, preparing profile of the prospective customers and prompt disposal of the loan proposals have placed OBC in the leading position but it must guard against ' adverse selection of borrowers.'

7.2.3.2 Sectoral Deployment of Bank credit

Deployment of resources is very crucial both for the banks and for the economy. For the banks, these have to meet the directives of the central bank and at the same time generate profits and for the economy these resources have to be efficiently allocated for most productive purposes. The important segments of credit allocation as stated in the Annual Reports of OBC are given below.

(a) Priority Sector Lendings :

Priority Sector Lendings : Bank-Groupwise : Comparative position

The comparative position of Oriental Bank Of Commerce and other selected banks and other bank groups are given in the following table :

Priority Sector Lendings : comparative Position (Rs. in crore) 10

Banks / Bank-Groups	1991-92 Amount	1991-92 % to total advances	1996-97 Amount	1996-97 % to total advances
Oriental Bank Of Commerce	740	40	2,055	42
State Bank Of India	11,646	39	16,946	38
Bank Of India	2,545	40	5,044	44
Public Sector Banks	43,573	38	79,131	42
Old Private Banks	1,798	28	6,515	43
New Private Banks	--	--	1,930	38
Foreign Banks	712	8	4,738	37

SOURCES :

10. Same as for item No. 8

Priority sector advances of Oriental Bank Of Commerce amounted to Rs. 740.39 crore at March-end 1992 and the share of priority sector advances to total credit stood at 40.43% meeting the stipulated level of 40% and it consistently increased to Rs. 2,054.74 crore in March 1997 and accounted for 42.02% of net credit. The important segments of priority sector financed by OBC have been analysed in the subsequent paragraphs.

* ***Advances to Agriculture :***

Agriculture is an important segment of priority sector advances. OBC's credit to agriculture sector increased from Rs. 281.03 crore in March 1991 to Rs. Rs. 338.44 crore as at the end of March 1992. The direct agricultural credit covering activities such as crop production, minor irrigation, land development, animal husbandry, farm mechanisation, bio-gas and horticulture etc. increased from Rs. 257.31 crore in March 1991 to Rs. 320.39 crore in March 1992 and constituted 17.5% of the total credit of the Bank. Increase in agricultural finance was maximum i.e. 37.1% during 1994-95. While direct agricultural advances increased from Rs. 426.17 crore in 1993-94 to Rs. 518.55 crore in 1994-95 (increase of 21.6%), indirect agricultural advances increased from Rs. 67.08 crore to Rs. 157.78 crore. Bank's credit to agriculture has consistently increased and total agricultural advance amounted to Rs. 968.43 crore in March 1997 and total number of agricultural finance accounts were 2,56,576. Bank's Direct agricultural credit amounted to 649.53 crore in March 1997 covering 1,38,793 borrowers. It constituted 18.24% of total net credit of the Bank exceeding the prescribed norm of 18%. The yearwise growth of agricultural advances by OBC in the post-reforms period is given in the following table :

Oriental Bank Of Commerce : Agricultural Finance

(Amount Rs. in crore) 11

Year	Amount	Percentage growth over the previous year
1991-92	338.44	20.4
1992-93	418.86	23.8
1993-94	493.25	17.8
1994-95	676.33	37.1
1995-96	826.45	22.2
1996-97	968.43	17.2

Integrated Rural Development Programme (IRDP), a national level programme for poverty alleviation, aims to provide productive asset and self-employment opportunities to the rural poor so as to bring them above the poverty line. The outstanding amount of financial assistance provided by

SOURCES:

11. Oriental Bank Of Commerce, Annual Reports 1991-92 to 1996-97

OBC increased from Rs. 25.92 crore in March 1992 to Rs. 29.83 crore in March 1997 covering 61,918 beneficiaries.

Service Area Approach (SAA) lays emphasis on decentralised planning from the village level upward and as such it is more pragmatic. It has been implemented by the Bank w.e.f. 1st April 1989. Credit to the tune of Rs. 49.61 crore was provided by the Bank under SAA during the year 1991-92. The Bank provides financial assistance under this Plan every year and financial assistance during the year 1996-97 amounted to Rs. 73.96 crore.

Lead Bank Scheme is based on area approach and it, therefore, ensures proper credit arrangement based on local conditions. OBC has been successfully discharging its obligations as Lead Bank in two districts since 1986. The Annual Credit Plans for the lead districts are prepared by the Bank as per the guidelines of Reserve Bank Of India and progress in implementation of the credit plans are monitored. During 1991-92, target of Rs. 132.34 crore was fixed under the Annual Credit Plans in both the lead districts and non-lead districts of the Bank under the above Scheme and the target was fully achieved. The targets are fixed on yearly basis and during the year 1996-97, loans aggregating Rs. 447.01 crore were disbursed by the Bank under the Scheme.

OBC has also been innovative and has evolved schemes for development of villages in consultation with the experts. In order to ensure that the fruits of progress are equitably shared by all, particularly the poor sections of the society, the Project named " Planning for Development of Villages (PDV) evolved by the National Institute Of Bank Management (NIBM) has been implemented by Oriental Bank Of Commerce. During the year 1991-92, 850 families were provided loans to the tune of Rs. 144.28 lacs. OBC initiated implementation of a new pilot project named ' Oriental Bank Gramin Project ' in 1995 in 19 Service Area Villages 2 districts. The project is primarily based on Self Help Group of NABARD and Bangladesh Gramin Bank's working system. By the end of the year, 217 groups of 5 persons each (mainly women) were formed and financial assistance amounted to Rs. 50 lacs in 1996-97 Group members savings amounted to Rs. 14 lacs upto 1996-97. The Bank is also providing training to rural folk in making products on local based raw materials. This has provided self-employment opportunities to the poor. The peculiarity of the project is 100% recovery. As regards refinance availed from NABARD by OBC, the total refinance availed upto March 1997 amounted to Rs. 179.11 crore with outstanding of Rs. 20.22 crore at March-end 1997. 12

Aiming at alround development of villages, Oriental Bank Of Commerce pioneered an innovative programme called Comprehensive Village Development Programme (CVDP) in 1997 offering comprehensive package to the villagers in selected villages. The Bank financed 515 beneficiaries to the tune of Rs. 96.85 lacs during 1997-98 besides providing various infra-structural support.

While social orientation of the Bank in agriultural finance is appreciable, it will have to keep the

SOURCES:

12. Oriental Bank Of Commerce , Annual Report 1996-97

operational cost minimum and also to ensure economic viability of the projects so that the Bank's profitability is not adversely affected.

** *Small Scale Industries*

Small scale industries are another important constituent of priority sector advances and occupy an important position in the Indian economy. The financial assistance by Oriental Bank Of Commerce to small scale industries in the post-reforms phase is given in the following table:

Oriental Bank Of Commerce
Advances to Small Scale Industries
(Amount Rs. in crore) 13

Year	Amount	Percentage growth over the previous year
1991-92	256.25	13.1
1992-93	358.72	40.0
1993-94	482.00	34.4
1994-95	610.05	26.6
1995-96	806.61	32.2
1996-97	852.08	5.6

Thus advances to small scale industries by Oriental Bank Of Commerce have steadily increased but maximum increase has taken place during 1992-93 and 1993-94 i.e. 39.8% and 34.6% respectively. The number of SSI accounts with the Bank increased from 16,747 in 1995-96 to 17,587 in 1996-97. The SSI advances to net credit of the Bank increased from 13.99% in 1991-92 to 17.43% in 1996-97.

The Bank has also extended credit facilities to various segments of priority sector under different schemes like advances to weaker sections (Rs. 502.23 crore in March-end 1997), Differential Rates of Interest (Rs. 17.39 crore at March-end 1997), Prime Minister's Rozgar Yozna (Rs. 11.88 crore at March-end 1997) in addition to the various schemes described in the foregoing paragraphs.

*** *Small Business Finance and other Priority Sectors*

Oriental Bank Of Commerce has also extended cedit to small business finance, transport operators, retail

SOURCES:

13. Oriental Bank Of Commerce , Annual Reports 1991-92 to 1996-97

trade, professional and self-employed persons, housing loan to weaker section and others. The financial assistance to these priority sector segments is given in the following table :

Oriental Bank Of Commerce: Other Priority Sector Advances
(excluding agricultural finance and SSI Advance)
(Amount Rs. in crore) 14

Year	Amount	Percentage growth over the previous year
1991-92	145.70	-0.03
1992-93	165.49	13.6
1993-94	150.07	-9.4
1994-95	164.78	9.8
1995-96	178.27	8.2
1996-97	195.86	9.9

Other priority sector advances of OBC increased from Rs. 145.70 crore in March 1992 to Rs. 195.86 crore in March 1997 representing increase of 34.4%, which shows commitment of the Bank to the small sectors of the economy for financial assistance.

*** *Export Credit*

Export credit is crucial for economic development. The financial assistance to exporters by Oriental Bank Of Commerce has registered significant increase in he post-reforms period as will be observed from the following data:

Oriental Bank Of Commerce : Export Finance
(Rs. in crore) 15

Year	Export finance	Percentage increase over the previous year
1991-92	127.23	71.6
1992-93	200.97	58.0
1993-94	370.88	84.5
1994-95	450.04	21.3
1995-96	590.56	31.2
1996-97	527.90	-10.7

SOURCES:

14 &15 Oriental Bank Of Commerce, Annual Reports 1991-92 to 1996-97

Thus export finance of OBC increased from Rs. 74.16 crore in March 1991 to Rs. 127.23 in March 1992 an increase of 71.6% during the year. Export finance has continued to grow and maximum percentage increase took place in 1993-94 i.e. 84.5%. Export finance crossed the level of 500 crore in 1995-96. The export finance of OBC reached Rs. 707.46 crore in March 1998 forming 11.20% of Bank's total net credit from 6.95% in March 1992. The significant increase in export finance has taken place due to several measures. Overseas Branches were opened to exclusively cater to the requirements of exporters and importers and number of such branches increased from 2 in 1991-92 to 6 in 1997-98 alongwith a Corporate Branch. The number of other branches authorised to handle foreign exchange business increased from 14 in 1991-92 to 22 in 1997-98. The Bank also organised from time to time exporter's meets to provide an insight to the customers into various export opportunities available as well as latest developments in foreign exchange operations and also sorting out difficulties, if any, both on the part of the Bank and its customers.

7.3 Foreign Exchange Business

In addition to the export finance, OBC handles imports and inward / outward remittances. The foreign exchange merchant turnover consisting of exports / imports and inward / outward remittances went up from Rs. 1132.32 crore in March 1992 to Rs. 4,482.65 crore as on March 31, 1997; representing average annual increase of 59.2%. It further increased to Rs. 5,154.35 crore as on March 31, 1998 representing growth of 14.98%. Total deposits of the Bank under various non-resident deposits schemes increased from Rs. 729.73 crore in March-end 1997 to Rs. 839.21 crore in March-end 1998. representing a growth of 15% over the previous year. Bank's total income from foreign exchange business increased from Rs. 22.77 crore in March 1992 to Rs. 88.81 crore in March 1997 an average annual increase of 58% during March 1992- March 1997. 16

The Bank has also reviewed regularly and upgraded the agency arrangements with the Overseas Correspondents. To ensure better service to the customers, the Bank had agency arrangements with 105 foreign banks in 1991-92, which increased to 138 in 1997-98. The Bank is maintaining 27 NOSTRO accounts in major currencies of the world. For speedier transmission of the messages in the world market, the Bank became a member of the Society for Worldwide International Financial Telecommunications. (SWIFT), Brussels and connectivity has been provided to Bank's 6 centres. The system, being a technological breakthrough, in the field of telecommunications, provides faster and reliable method of communicating with international bank community and also the international trading community.

7.4 CREDIT - DEPOSIT RATIO

Credit deposit ratio is an important mechanism to focus utilisation of dposits raised by banks for the purpose of lending. The table containing credit deposit ratio of selected banks / bank groups is given below:

SOURCES:

16. Oriental Bank Of Commerce, Annual Reports 1991-92 and 1996-97

Credit - Deposit Ratio : Bank Groupwise : Comparative Position 17

Banks /Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Oriental Bank Of Com.	48.99	51.89	49.00	52.88	53.63	48.60
State Bank Of India	73.67	71.92	54.31	57.01	62.06	59.70
Associate Banks	61.04	59.60	52.10	57.50	57.56	55.57
Nationalised Banks	56.45	53.34	45.77	48.00	49.28	45.56
Old Private Banks	52.45	51.81	48.83	52.90	57.82	54.88
New Private Banks	--	--	--	--	82.33	59.67
Foreign Banks	54.42	49.98	44.32	54.84	73.68	71.57
All Sch. Com. Banks	60.35	57.54	48.13	54.70	58.60	55.10
Bank Of India	65.45	59.18	50.99	49.87	56.67	57.35

In case of Oriental Bank Of Commerce Credit Deposit Ratio had a mixed trend. It increased in 1992-93, 1994-95 and 1995-96 but had a sharp decline in 1996-97 mainly due to higher growth rate of deposits and slower increase in credit offtake in the market.

7.5 INVESTMENTS IN SECURITIES

OBC's investments in Government, Trustee and other securities including treasury bills amounted to Rs. 1,316.17 crore as on March 31, 1992 as against Rs. 1,037.35 crore in March 1991. The investments made by the Bank increased from Rs. 2,916.64 crore March 1995 , to Rs. 4,388.22 crore in March 1997 and further to Rs. 5,957.25 crore as on March 31, 1998 registering annual increase of 58.8% during March 1992- March 1998. Interest on investments amounted to Rs. 493.55 crore in 1996-97 representing yield of 11.2% on investments as compared to 9.6% in 1991-92. Yearwise investment in securities by OBC is given in the following table:

Oriental Bank of Commerce
Investments in securities (Rs. in crore) 18

Year	Investment in securities
1991-92	1,316
1992-93	1,560
1993-94	2,522
1994-95	2,917
1995-96	3,584
1996-97	4,388

SOURCES: Given on the next page

Oriental Bank Of Commerce has followed the guidelines of Reserve Bank Of India to bifurcate investment in securities into " permanent " and " current ". OBC's ratio of " current investments " in approved securities stood at 78% in 1996-97, as against the prescribed norm of 50% and the remaining 22% was in category of "permanent" investments. In 1997-98, the entire portfolio of Government and other approved securities was brought by the Bank under " current " category and marked to market to the full extent.

7.6 PROFITABILITY ANALYSIS

7.6.1 Total Income

Total income of Oriental Bank Of Commerce , State Bank Of India, Bank Of India and other bank groups from 1991-92 to 1996-97 are given in the following table :

Total Income : Banks / Bank Groupwise Distribution

TOTAL INCOME [19] (amount in crore of rupees)

Bank Group / Banks	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	% average increase 1992-97
Oriental Bank Of Commerce	448	537	648	872	1,127	1,355	40.5
State Bank Of India	10,931	11,157	10,746	12,250	15,716	17,594	12.2
Bank Of India	2,658	2,318	2,260	2,650	3,311	4,004	10.2
Nationalised Banks	20,734	21,881	23,406	27,241	33,075	37,994	16.6
Old Private Banks	1,521	1,881	2,366	3,220	4,285	5,360	50.4
New Private Banks	--	--	--	--	1,000	1,980	19.6
Foreign Banks	3,709	3,938	4,086	4,668	6,085	7,589	21.0
All Sch. Com. Banks	39,392	41,663	43,763	51,544	65,064	76,200	18.7

SOURCES:

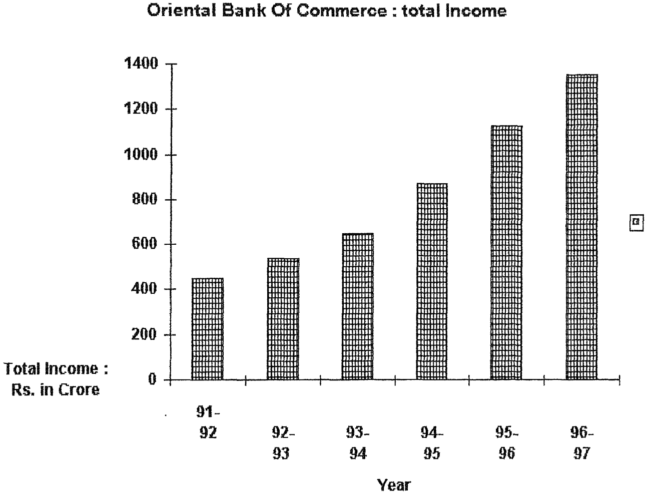
17. Indian Banks' Association Bulletin Vol. XIX No.3 March 1997 (Special Issue on Customer Service in Banks) and Performance Highlights of Banks 1996-97 , IBA publication and Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the years 1991-92 to 1996-97 and SBI Monthly Review April 1998 and Reserve Bank Of India Bulletin December 1997

18. Oriental Bank Of Commerce, Annual Reports from 1991-92 to 1996-97

19. Same as for item No. 17

Thus total income of Oriental Bank Of Commerce increased at an average annual rate of 40.5% from March 1992 to March 1997, which is higher as compared to two other selected public sector banks i.e. State Bank Of India (12.2%) and Bank Of India (10.2%), nationalised banks as a group (16.6%), foreign banks (21%), new private banks (19.6%) and also all scheduled commercial banks (18.7%) in March 1997. Only old private banks had a higher growth rate of 50.4%. The reasons for a high growth rate of total income of OBC has been examined in the subsequent paragraphs.

The growth of total income of Oriental Bank Of Commerce from 1991-92 to 1996-97 is represented by the following bar diagram prepared on the basis of the table given on the rpevious page:



Bar Diagram prepared on the basis of the Table given on the previous page

The above bar diagram shows that highest growth in total income of Oriental Bank Of Commerce took place in 1994-95 (34.6%) followed by the years 1995-96 (29.2%) and 1993-94 (20.7%), 1996-97

(20.2). 20 The high rate of income growth despite stringent IRAC norms shows a good performance on the part of Oriental Bank Of Commerce and shows better credit management.

The break-up of total income of Bank Of Commerce into Interest Income and Non-Interest Income during 1992-1997 is given in the following table:

Oriental Bank Of Commerce

Break-up of total income (Rs. in crore) 21

Year	Interest Income	% of Interest Income to Total Income	Non-Interest Income	% of Non-Interest Income to Total Income
1991-92	418	93.3	30	6.7
1992-93	496	92.4	41	7.6
1993-94	593	91.5	55	8.5
1994-95	786	91.0	86	9.0
1995-96	1,026	91.1	101	8.9
1996-97	1,251	92.3	104	7.7
Average % increase during 1991-92 to 96-97	39.9%	--	49.2%	--

It is observed from the above table that while interest income of Oriental Bank Of Commerce increased at an average rate of 39.9% from 1991-92 to 1996-97, its non-interest income increased at a faster rate of 49.2%. This shows that the Bank has actively explored other avenues of income like commission, exchange and brokerage business, profit on exchange transactions like remittances and income earned by way of dividend from companies. Interest income of the Bank has remained around 91% except 1991-92, 1992-93 and 1996-97 when it was 93.3%, 92.4% and 92.3% respectively. Both the major components under interest income i.e. interest and discount on advances and bills and also income on investments have increased. While average interest and discount income on advances has increased by about 39.24%, average interest income from investments has increased at an average rate of 58.4% during the aforesaid period. Interest income of OBC increased from Rs. 1,250.54 crore at March-end 1997 to 1458.04 crore in March-end 1998 registering an increase of 16.6% during the year. Non-interest income increased from Rs. 104.38 crore

SOURCES:

20. Oriental Bank Of Commerce, Annual Reports from 1991-92 to 1996-97
21. Oriental Bank Of Commerce Annual Reports 1991-92 , 1994-95 to 1997-98 and IBA Vol. XIX No.3 March 1997 Indian Banks' Association , Bombay

in crore at March-end 1997 to Rs. 138.45 crore at March-end 1998 representing an increase of 32.6% during the year.

7.6.2 Total Expenditure

Total expenditure plays a crucial role in profits of banks. The following table shows the total expenditure of Oriental Bank Of Commerce and other selected banks / bank groups in the post-reforms period i.e. from 1991-92 to 1996-97:

Total Expenditure : Banks / Bank Groupwise Data

TOTAL EXPENDITURE |22| (amount in crore of rupees)|

Banks/ Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	% increase 1992-97
Oriental Bank Of Commerce	421	517	616	759	954	1,175	35.8
State Bank Of India	10,756	10,945	10,471	11,534	14,884	16,244	10.2
Bank Of India	2,601	2,649	3,349	2,600	3,035	3,644	8.0
Nationalised Banks	20,136	25,454	26,111	26,972	34,235	36,549	16.3
Old Private Banks	1,439	1,820	2,236	2,861	3,908	4,960	48.9
New Private Banks	--	--	--	--	830	1,701	21.0
Foreign Banks	3,319	4,838	3,582	4,037	5,396	6,923	21.7
All Sch. Com. Banks	38,077	45,795	47,478	49,438	64,203	71,760	17.7

The above table shows that average increase in expenditure of Oriental Bank Of Commerce is 35.8% from 1991-92 to 1996-97, which is one of the highest among all the above banks / bank groups only next to Old Private Banks as a group having annual increase of 48.9% from 1991-92 to 1996-97. The highest increase

SOURCES:

22. Bulletin No. XIX No.3 March 1997 of Indian Banks' Association, Bombay and Annual Reports of Oriental Bank Of Commerce, Bank Of India and State Bank Of India for the years 1991-2 to 1996-97

has taken place on account of interest expended on deposits, which has been examined in detail in the following paragraphs. The possibilities of effecting economy and controlling controllable expenses may be examined by the Bank.

The break-up of total expenditure of Oriental Bank Of Commerce under main heads viz. interest expended, operating expenses and provisions and contingencies is given in the following table so that various components thereof can be analyzed :

Oriental Bank Of Commerce :
Break-up of Total Expenditure
(Rupees in crore) 23

Year	Interest Expended	Operating Expenses	Provisions & contingencies	Total
1991-92	250	101	70	421
1992-93	362	119	36	517
1993-94	395	143	78	616
1994-95	472	205	82	759
1995-96	626	225	103	954
1996-97	801	254	120	1,175

The highest average annual increase of 44.08% (from 1991-92 to 1996-97) has taken place under the head interest expended because of increase in total deposits and large component whereof have been time deposits. Consequently, the cost of deposits has increased from 6.5% in 1991-92 to 7.8% in 1996-97.

As regards year-wise position, largest increase of 43.3% in operational expenses took place in 1994-95 due to wage revision in banks at industry level. Provisions and contingencies in contrast to other banks declined from Rs. 70 crore in 1991-92 to Rs. 36 crore in 1992-93, whereas in other banks there was significant increase under this head from the years 1991-92 to 1993-94. It is due to lower level of Non-Performing assets of OBC as compared to other selected banks and bank groups, which has been analysed later in this Chapter.

7.6.3 *Net Interest Income (Interest Spread)*

The interest spread as percentage to total income of selected banks / bank groups from 1991-92 to 1996-97 are given in the following table:

SOURCES:

23. Same as item No. 20

Name of the Bank / Bank Group	Net interest income (Interest Spread) as % to Total Assets 24					
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Oriental Bk. Of Com.	4.29	2.83	3.29	3.81	3.80	3.89
Bank Of India	2.25	1.82	2.07	2.59	2.88	3.00
State Bank Of India	3.63	2.95	2.61	3.25	3.28	3.43
19 Nationalised Banks	2.86	2.02	2.17	2.73	2.92	2.97
Total Public Sector Banks	3.22	2.39	2.36	2.92	3.08	3.16
25 Old Private Banks	4.02	2.91	2.97	3.04	3.14	2.96
9New Private Banks	--	--	--	1.17	2.84	2.91
39 Foreign Banks	3.92	3.56	4.21	4.24	3.74	4.09
100 Sch Com. Bks.	3.31	2.51	2.54	3.00	3.13	3.22

After 1992-93, the net interest income as percentage to total assets of Oriental Bank Of Commerce has improved and it was 3.81% in 1994-95 and after marginally declining to 3.80% in 1995-96, it again increased to 3.89% in 1996-97, which is higher than 3.43% in respect of SBI and 3.00 in case of Bank Of India. OBC is much better placed in regard to interest spread due to lower NPAs and higher yield on advances (14.5% for OBC as compared to scheduled commercial banks' average of 13.7% in 1996-97).

7.7 NET PROFIT

Net profit of Oriental Bank Of Commerce has steadily increased in the post-reforms period except 1992-93 when net profit declined from Rs. 26.78 crore in 1991-92 to Rs. 20.50 crore in 1992-93. The main reason was increase of 22.8% in expenditure as against increase of 20% in total income. The comparative position of the selected banks / bank groups is given in the following table:

SOURCES:

24. Report on Trend and Progress of Banking in India 1996-97 (July-June)

Net Profit : Bank-Groupwise : Comparative Position

1 NET PROFITS 25 (Rs. in crore)

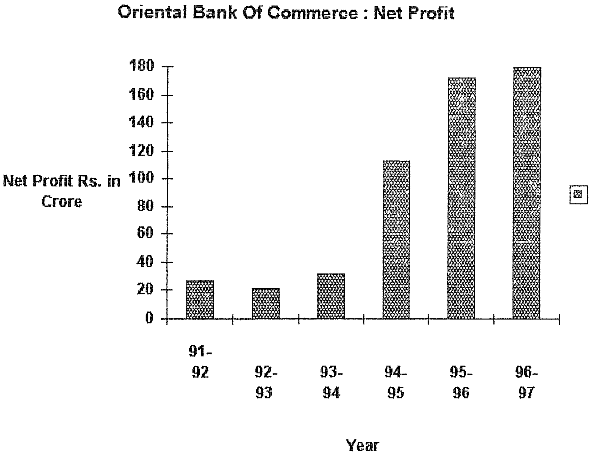
Bank / Bank Group	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	Average % increase 1991-92 to 1996-97
Oriental Bank Of Commerce	27	21	32	113	173	180	22.7
State Bank Of India	175	212	275	715	832	1,329	26.4
Bank Of India	57	-331	-1,089	50	276	360	21.3
Nationalised Banks	600	-3573	-4705	269	-1,161	1,445	5.6
Old Private Banks	81	61	130	359	377	400	15.8
New Private Banks	--	--	--	--	165	278	13.7
Foreign Banks	387	- 899	504	631	689	666	2.9
All Sch. Com. Banks	1,313	-4,131	-3,715	2,106	861		

It is observed from the above table that like other banks in India, net profit of Oriental Bank Of Commerce declined from Rs. 27 crore in March 1992 to Rs. 21 crore in March 1993. Net profit of OBC increased by 52.4% in March 1994. But highest percentage increase of net profit (253.1%) was recorded in March 1995 because of 34.6% increase in total income as compared to only 23.2% increase in total expenditure. Both increase in interest and non-interest income contributed to higher increase in total income. In 1996-97 percentage increase in net profit was only 4% because total income increased by 20.2% whereas total expenditure increased at a higher rate of 23.1%. Interest expended having the lion's share, the Bank will have to explore the avenues of low cost deposits as well.

SOURCES:

25. Reserve Bank Of India , Bulletin 1997

The net profit of OBC during 1991-92 to 1996-92 is represented by the following bar diagram :



<u>**Bar diagram prepared on the basis of table given on the previous page**</u>

7.8 <u>NON - PERFORMING ASSETS (NPAS)</u>

The quantum of non-performing assets as a percentage of advances is one of the critical indicators of the quality of a bank's loan portfolio and hence of its profitability. The Net Non-Performing Assets of OBC as percentage of net credit was 4.14% in 1994-95, which improved to 3.66 in 1995-96 but it again increased to 5.84% in 1996-97. However, subsequently it improved to 4.5% in 1997-98. 26 The comparative position of NPAs to net advances is given in the following table:

<u>SOURCES:</u>

26. Oriental Bank Of Commerce, Annual Reports from 1991-92 to 1996-97

Percentage of Net Non-Performing Assets to Net Advances Comparative Position 27

Particulars	1995-96 % of Net NPAs to Net Advances	1996-97 % of Net NPAs to Net Advances
Oriental Bank Of Commerce	3.66	5.84
State Bank Of India	6:61	7.30
Bank Of India	7.00	6.52
Total Nationalised Banks	10.14	10.07
25 Old Private Banks	4.51	5.99
9 New Private Banks	--	2.07
39 Foreign Banks	0.81	2.50

Oriental Bank Of Commerce has lower Non-Performing Assets as percentage to Net advances as compared to State Bank Of India, Bank Of India, Nationalised Banks and Old Private Banks as a group in both the years 1995-96 and 1996-97. New Private Banks being and foreign have lesser NPAs because they started later and they do not have rural lendings portfolio, where repayment is seriously affected due to vagaries of nature. The aforesaid percentage of net NPAs of OBC had risen from 3.66% in 1995-96 to 5.84% in 1996-97 but it was able to contain them to 4.5% in 1997-98.

In order to further improve the quality of loan assets, greater thrust was laid by OBC on the aspects of pre-sanction scrutiny of loan proposals and post-lending follow-up / supervision of advances and charging of securities. Timely renewal / review of credit limits is another thrust area.

7.9 CAPITAL ADEQUACY RATIO

Capital Adequacy Ratio (CAR) also known as Capital Adequacy to Risk Weighted Assets (CRAR) is a crucial factor in prudential norms prescribed for banks as a part of banking sector reforms. During 1991-92, with the contribution of Rs. 20 crore to the share capital of Oriental Bank Of Commerce by the Central Government and transfer of Rs. 24 crore by the Bank to reserves out of profits, the ratio of capital and reserves to working funds rose from 2.15% to 2.85%. OBC launched the public issue in October 1994 and mobilised Rs. 387.24 crore and the ratio of capital and reserves to working fund went up sharply from 4.08 % in March 1994 to 8.61% in March 1995.

SOURCES:

27. Report on Trend and Progress of Banking in India 1996-97 (July-June)

As result of significant increase of 190.06% in the capital and reserves as compared to 58.74% in risk-weighted assets, the Capital Adequacy Ratio of OBC rose to 18.69% as on 31.3.195 as against 10.23% as on 31.3.1994. The CAR was 16.99% at March-end 1996 rising to 17.53% in March 1997 as compared to the norm of 8% prescribed by Reserve Bank Of India. The comparative position of selected banks is given in the following table:

Capital Adequacy Ratio of OBC, SBI, BOI
and the top New Private Bank and Foreign Bank 28

Banks	**1995-96 Capital Adequacy Ratio**	**1996-97 Capital Adequacy Ratio**
Selected Public Sector Banks		
Oriental Bank Of Commerce	16.99	17.53
State Bank Of India	11.60	12.17
Bank Of India	8.44	10.25
New Private Sector Bank With highest CAR in 1996-97		
Centurion Bank Ltd.	60.00	27.00
Foreign Bank With highest CAR in 1996-97		
Commercial Bank Of Korea	N.A.	885.56

As regards public sector banks, Oriental Bank Of Commerce had the highest Capital Adequacy Ratio both in 1995-96 and 1996-97. State Bank Of India was the second highest in PSBs in 1996-97. The top Private Banks and Foreign Banks had better CARs.

7.10 FINANCIAL RATIOS

Financial ratios are important tools for examining health and efficiency of commercial organisations.

SOURCES:

28. Reserve Bank Of India, Bulletin December 1997

The important financial ratios of Oriental Bank Of Commerce, State Bank Of India and Bank Of India are given in the following table:

Financial Ratios : Comparative Data

29

Indicators	1991-92 Oriental Bank of Commerce	1991-92 State Bank Of India	1991-92 Bank Of India	1996-97 Oriental Bank Of Commerce	1996-97 State Bank Of India	1996-97 Bank Of India
Gross Profit as % to total assets	2.43	2.72	1.41	2.60	2.17	1.53
Net Profit as % to total assets	0.67	0.18	0.24	1.56	0.85	0.95
Interest Income as % to total assets	10.54	10.03	10.18	10.82	9.55	9.26
Interest Spread as % to total assets	4.29	3.63	2.92	3.89	3.43	3.00

Gross Profit as percentage to total assets of Oriental Bank Of Commerce has improved from 2.43% in 1991-92 to 2.60% in 1996-97 and was highest as compared with 2.17% for State Bank Of India and 1.53% for Bank Of India. This ratio of OBC is also better than Public Sector Banks as a group, where it was 1.60% in 1996-97. Similarly net profit as percentage to total assets ratio of 1.56% of OBC in 1996-97 is better than SBI (0.85%) and BOI (0.95%) and also than that of 27 PSBs as a group (0.56% in 1996-97).

The reasons for higher gross and net profit as percentage to total assets in respect of OBC are higher interest income as percentage to total assets, lower net NPAs as ratio of net advances and consequently lower provisions and contingencies.

The other financial ratios of OBC and other banks in respect of expenses are also given in the

SOURCES:

29. Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the respective years and also Report on Trend and Progress of Banking in India, 1996-97 (July-June), Reserve Bank Of India

following table:

Expense Ratios : Comparative Position of Selected Banks 30

Indicators	1991-92 Oriental Bank of Commerce	1991-92 State Bank Of India	1991-92 Bank Of India	1996-97 Oriental Bank Of Commerce	1996-97 State Bank Of India	1996-97 Bank Of India
Interest Expense as % to total assets	6.25	6.40	7.93	6.59	6.13	6.25
Provision as % to total assets	1.76	2.54	1.16	1.04	1.32	0.58
Intermediation cost as % to total assets	2.53	2.37	2.11	2.19	2.94	2.77

Interest expense as percentage to total assets is higher in the case of OBC than SBI and BOI in 1996-97. This is due to higher proportion of fixed deposits, which involve a higher cost. Provisions as percentage of total assets is lower for OBC as compared to SBI but higher than BOI. As regards intermediation cost as percentage to total assets in 1996-97, OBC had succeeded in reducing it from 2.53% in 1991-92 to 2.19% in 1996-97 whereas it has increased in respect of SBI and BOI. Therefore, OBC had a lower ratio (2.19) than SBI (2.94) and BOI (2.77) and also PSBs as a group (2.88%) in 1996-97. The above ratios show a strong position for OBC both in regard to generation of income and also control of expenses except interest expenses, which are highest for Oriental Bank Of Commerce and require a better planning.

We shall also examine other ratios like return on assets, return on equity in the following table in respect of OBC and comparative position with other banks:

Other Ratios : Comparative Position 31

Indicators	1991-92 Oriental Bank of Commerce	1991-92 State Bank Of India	1991-92 Bank Of India	1996-97 Oriental Bank Of Commerce	1996-97 State Bank Of India	1996-97 Bank Of India
Return on assets %	0.670	0.185	0.243	1.56	0.880	1.01
Return on Equity %	23.49	11.97	8.49	19.14	16.77	18.57

SOURCES:

30 & 31. Reserve Bank Of India, Bulletin December 1997 and OBC Annual Reports 1991-92 and 1996-97

Oriental Bank Of Commerce had highest Return on Assets in 1991-92 among the selected three banks and it improved from 0.670% in 1991-92 to 1.56% in 1996. ROE of Oriental Bank Of Commerce declined from 23.49 in 1991-92 to 19.14 in 1996-97, which implies that net profit has not proportionately increased to the induction of capital and transfer of reserves. Despite the decline of ROE of Oriental Bank Of Commerce in 1996-97, it was highest among the selected banks.

7.11 PRODUCTIVITY RATIOS

Deposit Per-Employee & Advances Per Employee : Bank / Bank Groupwise : Comparative Position

(Rs. in lakh) 32

Banks / Bank-Groups	1991-92 Deposit per-Employee	1991-92 Advances per-employee	1996-97 Deposit per-employee	1996-97 Advances per-employee
Oriental Bank Of Commerce	33.15	16.24	74.04	35.98
Bank Of India	35.88	23.48	59.37	34.05
State Bank Of India	26.74	19.70	46.87	26.35
Associate Banks	20.16	12.31	45.30	25.17
Nationalised Banks	28.14	15.88	52.60	23.97
Old Private Banks	23.19	12.16	64.48	35.39
New Private Banks	--	--	532.83	317.95
Foreign Banks	128.74	70.06	268.73	192.32

The deposits and advances per employee for Oriental Bank Of Commerce have improved from Rs. 33.15 lacs and Rs. 16.24 lacs in 1991-92 to Rs. 74.04 lacs and Rs. 35.98 lacs respectively in 1996-97. These ratios of OBC in 1996-97 were highest among the selected banks, which shows hiigher productivity of their employees. The deposits and advances per employee were highest in respect of new private banks and foreign banks in 1996-97 mainly due to their smaller set up and comparatively larger size of accounts.

Net profit per employee is another important ratio for testing the efficiency of banks. It increased more than five times from Rs. 24,666 in 1991-92 to Rs. 1,33,000 in 1996-97 in respect of Oriental Bank Of Commerce and was highest among the selected three banks as would be observed from the following table:

SOURCES:

32. Annual Reports of State Bank Of India , Bank Of India and Oriental Bank Of Commerce for the respective years and also Report on Trend and Progress of Banking in India, 1996-97 (July-June), R B I

Net Profit per employee : Comparative Position 33

Indicators	1991-92 Oriental Bank of Commerce	1991-92 State Bank Of India	1991-92 Bank Of India	1996-97 Oriental Bank Of Commerce	1996-97 State Bank Of India	1996-97 Bank Of India
Net Profit per employee (Rs)	24,666	7,815	10,576	1,33,000	56,278	67,548

7.12 Merchant Banking Activity

As a measure of diversification, the Bank has also undertaken merchant banking activities. Unlike State Bank Of India or Bank Of India, it does not have a separate subsidiary to handle merchant banking business but OBC itself conducts this business. It undertakes underwriting commitments, acts as a lead manager and co-manager to the issues, appraises projects and acting as a banker to the issues, undertakes activities like handling of refund orders, interest and dividend warrants etc.

7.13 CONTINGENT LIABILITIES

Contingent liabilities of Oriental Bank Of Commerce amounted to Rs. 676.31 crore in March 1992 representing 16.9% of total liabilities / assets of the Bank and increased to Rs. 1,418.99 crore in March 1997 accounting for 12.3% of total assets / liabilities of the Bank. Liabilities on account of outstanding forward exchange contracts, guarantees given on behalf of constituents in India and abroad and acceptances, endorsements and other obligations worked out to 93.4% of the total contingent liabilities in March 1997. As such liabilities will increase with increase in non-fund based business, banks must evolve suitabe strategies to effectively manage such risks. 34

7.14 USE OF MODERN TECHNOLOGY

Following agreement with Trade Unions at Banking Industry Level in October 1993, Oriental Bank Of Commerce drew plan for computerisation of eligible branches. The process of mechanisation /

SOURCES:

33 & 34. Annual Reports of Oriental Bank Of Commerce 1991-92 and 1996-97

computerisation was continued by the Bank at all the three tiers viz. Head Office, Regional Offices and branches. With thrust on modernisation / computerisation, 26 branches of the Bank were fully computerised and 125 partially computerised by the year 1996-97. During 1997-98, 25 more branches were fully computerised taking total number of such branches to 51 and the number of partially computerised branches became 150. Internet connectivity was installed both at Regional Offices and Head Office of the Bank. The Bank has operationalised three Automated Teller Machines (ATMs); two of which are under the Shared Payment Network System. 35

Thus technology upgradation by Oriental Bank Of Commerce is based on four considerations : (a) improvement in customer service, (b) increase in productivity, (c) cost effectiveness by sharing the SPNS system and (d) better control and supervision.

7.14 HUMAN RESOURCES DEVELOPMENT

Oriental Bank Of Commerce attaches great significance to its human resources and their development. Human resources development and their proper orientation is considered to be an effective management approach in staff motivation to attain their total involvement in organisational growth. Qualitative customer service, innovative products and services, professional management, computerisation, use of state-of-the-art technology, harmonious industrial relations and change of attitudes and development of employees in all disciplines of banking are important areas for removing the road blocks towards progress and growth. Training being an important HRD function, the training activities occupy Bank's utmost attention and cover latest matters as credit management, project financing, post sanction credit monitoring and follow-up, reduction of NPAs, leasing service, marketing and total quality management etc.

An atmosphere of cohesiveness prevails in the organisation at all the levels. Efforts are made to induct professionalism in the Organisation and commercial work culture are given a thrust. High sense of commitment and dedication at all levels are the hall Mark of achieving better results.

7.15 CUSTOMER SERVICE

As a Corporate Policy of Oriental Bank Of Commerce, the customer continues to be focal point of all the activities at the grassroots level. The Bank, being a customer friendly bank, has gone even a step forward in creating awareness among its customers towards their rights by bringing out ' Citizens Charter ', which speaks about the schemes, services and facilities available to them vis-à-vis obligations of the Bank. The

SOURCES:

35. Annual Reports of Oriental Bank Of Commerce 1996-97 and 1997-98

various endeavours of the Bank include better customer amenities, additional lockers, specialised branches, introduction of computer technology to render more efficient service and reorienting the staff by training to render excellent service and meet customers' varying needs in the fast changing and competitive environment.

A survey on the quality of the Bank's customer service was conducted by the National Institute of Bank Management (NIBM). The Survey brought about that the level of customer service was generally good and OBC was customer friendly bank. The Bank further strengthened the areas for expediting the process of collection of instruments, popularization of remittance facilities, opening specialised branches and equipping the staff with the latest developments etc., as suggested in the Survey. Systems and procedures remain under constant study and suitable refinements / modifications including technological advancement are brought about to ensure efficient and prompt service to the customers.

7.16 CONCLUSION

Thus Oriental Bank Of Commerce is smallest as compared to the other two banks i.e. State Bank Of India and Oriental Bank Of Commerce. Small size is its advantage. It can exercise better control over its branches, which is very crucial to ' Brach Banking System ' prevalent in India as against ' Unit Banking System ' in vogue in United States Of America. It can mould faster to the fast changing financial scenario worldwide. The smaller base gives better percentage results both in terms of growth and profitability and it is in a position to plan its progress on the lines chosen by it, of course, within the norms prescribed by Reserve Bank Of India.

Oriental Bank Of Commerce is well on path of progress. The progress achieved by OBC, as analysed by us earlier, places it amongst the fastest growing banks in India. The branches, which deliver the products and services have grown from 533 in March 1992 to 755 branches in March 1997 (total growth of 41.06% and average annual growth of 8.3%) during a phase when branch expansion has considerably slowed down in case of other public sector banks as they are busy in consolidation).

As regards deposits, OBC has crossed Rs. 10,000 crore mark (Rs. 10,054 crore) at March-end 1997 as compared from Rs. 3,599 crore at March-end 1992, average annual growth rate of 35.9 percent. This growth rate is higher than not only the public sector banks as a group but also higher than foreign banks (24.3%) and new private banks (24.1). This outstanding growth has enabled the bank to increase its market share in deposits from 1.5% to 2% (March 1992-March 1997). As the proportion of time deposits is quite high and these are high cost deposits as compared to other banks, OBC has to evolve suitable strategies for mobilising larger proportion of demand deposits.

Resources have to be profitably deployed for productive purposes. Accordingly, advances of OBC have also grown and crossed Rs. 4,000 crore mark (4,886 crore) in March 1997 as compared to Rs. 1763 crore March-end 1992; average annual growth of 35.4% surpassing domestic advances growth rate of all the bank groups except foreign banks (38.3%). In the process it has augmented its market share from 1.3% to 2%

during the above period. These growth rates place OBC as one of the leading performers as far as growth parameters are concerned.

OBC has achieved the target of 40% in respect of priority sector lendings laid down by Reserve Bank Of India (42.% in March 1997). While comparative data of recovery of such loans is not available, it has to be ensured that quality of lending is maintained. Such lendings should be placed on two strong pillars of sound appraisal of loans by the banks alongwith vigorous follow up so that end use of funds is ensured. After all creation of the productive assets and repayment of loans on time are the important objectives for such loans.

Not having subsidiaries or foreign branches may not be deemed as a weak point for OBC as long as its competitive edge is not affected and alternate arrangements are made to tap the profitable business. Subsidiaries function as separate entities of the holding company. The purpose of a subsidiary is to have focused attention on that specific activity and building the expertise. This can be achieved by the main banking company through required planning and developing required skill among the staff. The requirement of foreign branches can be made up by having correspondent relationship with the banks abroad or the banks in India providing these facilities abroad. But in the long run OBC may plan subsidiarisation for focused attention on specified activities.

The important ingredients of profit are interest spread and non-interest income. While OBC has done well on the first count i.e. interest spread, it has to improve its non-interest income. The comparative position of interest spread ratio in March 1997 is : OBC (3.89%), SBI (3.43%), BOI (3%), PSB as a group 3.16%, new private banks (2.91%) and total SCB (3.22%). Thus the ratio of OBC in regard to interest spread is highest among the aforesaid banks. Foreign banks , however, have a beeter ratio (4.09). As regards non-interest income ratio to total assets of OBC, it was 0.90% in March 1997 and was lower than other banks (SBI 1.69%), BOI (!.29%) and OBC ranked 15th out of 19 nationalised banks. It shows that OBC has to explore further avenues of non-interest income.

The profitability of Oriental Bank Of Commerce has improved in the post reforms period. Net profit of OBC increased from Rs. 26.78 crore at March-end 1992 to Rs. 180 crore in March 1997 and thereafter, crossed Rs. 200 crore mark (Rs. 210 crore) in 1997-98; annual average increase of 107.8%. With this achievement the earning per share of OBC was Rs.10.91 and Return on assets was 1.4% in March 1998 as compared to State Bank Of India (EPS Rs. 35.36 and ROA 1.09%) and Bank Of India (EPS Rs. 5.71 and ROA 0.86%). The productivity per employee in OBC has also improved and business per employee was Rs. 134.8 lac in March 1998 as compared to Rs. 106.07 lacs per employee for SBI and Rs. 116.84 lacs for BOI. The net profit per employee has also improved from Rs. 1.33 lacs in 1991-92 to Rs. 1.5 lacs in 1997-98 and also as compared to Rs. 0.77 lacs for SBI and Rs. 0.69 lacs for BOI in 1997-98.

The high cost of deposits is a weak point for Oriental Bank Of Commerce. The primary reason is higher proportion of time deposits (increasing from 62.81% in 1991-92 to 68.65% in 1996-97). With this

increased ratio, the cost of deposits has also increased from 6.5% to 7.5% during the relevant period. Interest expenditure as percentage to total assets has consequently increased from 6.25% in 1991-92 to 6.93% in 1996-97. This ratio is higher than the ratio of public sector banks as group i.e. 6.53% in 1996-97 OBC, will have to look into this aspect to analyse the specific reasons for the higher cost and also to work out the cost benefit analysis.

The Non-Performing Assets (NPAs) as percentage to net advances of Oriental Bank Of Commerce, has gone up to 5.84% in March 1997 as compared to 3.66% in March 1996. The ratio of OBC is better than SBI and BOI but this no ground for consolation because it a steep rise. OBC had endeavoured to contain it and succeeded in containing it to 4.5% at March-end 1998. However, two aspects need special mention : one relates to recovery of dues in respect of the existing NPAs and the other is gearing up follow-up of standard assets so that they do not slip into NPA category.

The Capital to Risk-Weighted Ratio (CRAR) of OBC has improved from 16.99% in March 1996 to 17.53 % in March 1997. This is a good progress and it has to keep it up in future.

Oriental Bank Of Commerce has also laid thrust on customer service. Taking pro-active initiatives like bringing out ' Citizens' Charter' to make the customers aware of the Bank's schemes, services and facilities and what is more important is obligations of the Bank to the customers. This gesture creates a positive impact on the customers. Specialised branches for different segment of customers and providing customer amenities are other important areas of customer service. Application of computers and information technology has provided competitive edge to the Bank by facilitating product innovation and enhancing productivity.

Human resources are valuable resources. They build culture of the organisation and as such their proper training undertaken by the Bank assumes great significance, where the aim is to develop the required skills and proper attitude to work and the customers.

Thus Oriental Bank Of Commerce has performed well on most of the parameters and is expected to achieve further milestones in growth and efficiency parameters. Three factors will be crucial: (a) raisning low cost deposits, (b) ability to meet the edge of growing competition by application of latest technolgy and excellent customer service and (c) the expertise and core competencies to diversify in the niche and emerging market segments and at the same time managing the growing risks.

Among the selected three banks, one has performed best in a few efficiency parameters, while the other has performed well in the other parameters. Therefore, it is a complex proposition to decide which bank has, inter se, performed better. We have, therefore, devised an augmented scoring model to work out their comparative performance. We have tried to make the model as simple and as comprehensive as possible so that it can be worked out on the basis of the available data furnished by the banks in their annual reports. This model has been presented in the next Chapter.

CHAPTER VIII

COMPARATIVE POSITION OF SELECTED BANKS AND DEVELOPMENT OF A MODEL " BANKEM "

8.1 Introduction

8.2 Existing Models for evaluating the performance of banks

8.3 Creation of a new 'Bank Efficiency Model' ('BANKEM')

8.4 Projection of the Modal

(i) Branches Network : Domestic as well as foreign

(ii) Market Share

(iii) Income Ratios

(iv) Expenses Ratios

(v) Profitability Ratios

(vi) Productivity Ratios

(vii) Technology Ratios

(ix) Efficiency Ratios

(x) Diversification Base

(x i) Prudential Norms Ratio

8.5 Presentation of the Ratios by equation

8.6 Application of the parameters and valuation norms to the selected banks

8.7 Grade Scores allotted to the banks

8.8 Interpretations and assignment of numerical values

8.9 SWOT Analysis of the selected banks

8.10 Conclusion

CHAPTER VIII

COMPARATIVE POSITION OF SELECTED BANKS AND DEVELOPMENT OF A MODEL " BANKEM "

8.1 INTRODUCTION

In the previous three chapters we have presented and analysed growth, profitability and productivity parameters of State Bank Of India, Bank Of India and Oriental Bank Of Commerce in absolute terms and also in terms of selected financial ratios. One bank is highly proficient in one area, while the other leads in another area. A comparison in totality is, therefore, a complex matter. Some leading financial periodicals perform the rating exercise of banks after publication of their annual reports but academic part of the analysis is not available.

8.2. EXISTING MODELS FOR EVALUATING THE PERFORMANCE OF BANKS

In order to comprehensively evaluate the performance of the commercial banks, two models have been developed; one by Dr. K. Satyanarayana 1 and another by Sri V.S.Kaveri 2 jointly with Sarva Shri K.Swarup and N.B.Shete of National Institute of Bank Management. The Model Of Sri Satyanarayana is based on ' market share concept .' The factors are divided into input and output factors. Input factors comprise of network of branches, number of staff, wage bill and non-wage operating expenses. The output factors consist of deposits, advances, investments, interest spread, non-interest income and net profit etc. The model of Sri Kaveri and others is known as ' Branch Performance Evaluation and Scoring Model.' They assess the performance of a branch through a set of indicators representing different dimensions like deposit mobilisation, loans and advances, productivity and profitability, customer service, house-keeping and bank marketing etc. These models make a deep study of the performance of banks but they serve a different purpose. The first model differentiates between input and output and this differentiation in a multi-product

SOURCES :

1&2 Ibid.

service industry like banking sector is a matter of debate. Some bankers go to the extent of treating deposits as 'input' and they treat advances as 'output'. The other model i.e. a scoring model is a useful tool to assess branch performance, which is a micro level analysis and we are conducting a project at macro level.

8.3 CREATION OF A NEW 'BANK EFFICIENCY MODEL (BANKEM)'

In the above perspective, we needed a model for the comparative assessment of three banks selected by us and at the same time having its utility for future analysis of larger number of target groups. While developing the model, a few emerging factors deserve attention like diversification ratio and technology ratio. With subsidiaries being floated by banks to undertake specialised functions like factoring , mutual fund and housing finance etc., diversification ratio assumes significance. Computerisation has also become a useful tool for customer service and credit appraisal in addition to various functions, and, therefore, technology ratio assumes significance. We have, therefore, developed a model which we have termed as ' **Bank Efficiency Model (BANKEM).'**

8.4 PROJECTION OF THE MODEL

Projection of a model has its own complexities when we are dealing with the financial statements comprising of profit and loss account and balance sheet. New dimensions are added up in the present context of diversification, globalisation and computerisation. On the top of it, the parameters should be such that data is available or could be worked out from the annual reports of banks or Reserve Bank Of India publications. Keeping in view the above factors, we have identified the following parameters:

8.4.1. BRANCH NETWORK : DOMESTIC AS WELL AS FOREIGN

Network of branches provides a strong base for delivery of services. It is very crucial for mobilisation of deposits, lending activities, ancillary services and also the latest non-fund based business. In India, we have yet to reach the stage of ' virtual banking '(where customers are not required to go to branches and they log in their business requirements via their computer network or advanced teller machines) and as long as we are handling ' actual banking ', branch network will be a powerful base. Some bankers suggest another variable i.e. specialised branches as they are more customer oriented. While the argument is well taken but there is no end to such divisions and this angle may enlarge further going into population-wise classification i.e. rural, semi-urban, urban and rural. A rural branch may have greater social orientation but its cost of operation may be higher. Instead of going into the areas of controversy, we taken the following two parameters :

(i) Network of Branches in India

(ii) Network of Foreign Branches

8.4.2. *MARKET SHARE*

Deposits and advances are two strong parameters for judging the market share of banks. As we have earlier separately taken the network of foreign branches as a parameter, we have taken here the data of domestic deposits and advances in India. Several factors contribute to market share viz. thrust in different market segments, generic schemes, product innovation and application of computers and information technology etc to suite the requirements of different customer groups. Thus market share is governed by both traditional factors as well as latest technological advancements. We have taken the following two parameters for market share :

(i) Market Share of Domestic Deposits (M S D)

$$\text{MSD} = \frac{\text{Total Domestic deposits of the concerned Bank}}{\text{All Scheduled Com. Banks Domestic Deposits}} \times 100$$

(ii) Market share of Advances in India (M S A)

$$\text{MSA} = \frac{\text{Total Advances of the concerned Bank in India}}{\text{All Scheduled Commercial Banks Advances in India}} \times 100$$

8.4.3 INCOME RATIOS

Income ratios play a crucial role in viability of banks. Interest spread representing difference between interest earned on advances and interest expended on deposits is crucial determinant of bank' profits. The other component is non-interest income, which is becoming more important as it is non-fund based and with likely shrinkage of interest spread due to competition, it will assume a special role in times to come. We have taken the following two income ratios. In order to provide objectivity, we have taken the aforesaid factors as percentage to total assets.

(i) Interest spread as percentage to total assets (ISR)

$$\text{Interest Spread Ratio} = \frac{(\text{Interest earned on advances} - \text{interest expended on deposits})}{\text{Total assets of the concerned Bank}} \times 100$$

(ii) Non-interest income as percentage to total assets (NII)

$$\text{Non-Interest Income Ratio} = \frac{\text{Non-Interest Income of the concerned Bank}}{\text{Total Assets of the concerned Bank}} \times 100$$

8.4.4. *EXPENSES RATIOS*

Intermediation ratio is an important expenses ratio. For Indian banks wage bill is an important element of intermediation and for foreign banks computerisation expenses represent an important component of intermediation. We have taken the following ratio for our grading purposes :

$$\textbf{Intermediation Cost Ratio (ICR)} = \frac{\text{Intermediation Cost of the concerned Bank}}{\text{Total Assets of the concerned Bank}} \times 100$$

8.4.5 *PROFITABILITY RATIOS*

Profits may be either gross profit (including provisions and contingencies) or net profit. Both are important indicators of viability. Accordingly, We have taken the following gross profit and net profit ratios for our analysis:

(i) Gross profit / loss as percentage to total assets (G P R)

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit of the concerned Bank}}{\text{Total Assets of the concerned Bank}} \times 100$$

(ii) Net profit as percentage to total assets (N P R)

$$\text{Net Profit Ratio} = \frac{\text{Net Profit of the concerned Bank}}{\text{Total Assets of the concerned Bank}} \times 100$$

8.4.6 *PRODUCTIVITY RATIOS*

Productivity ratios may represent data either per employee or per branch. Business per employee is the data used by us because it gives more objective assessment. In business of commercial banks, conventionally deposits plus advances data is taken into account. We have adopted the same principle as other facets like profits and non-interest income factors have been accounted for elsewhere. Thus the ratio adopted by us is the following :

$$\textbf{Business Per Employee (BPR)} = \frac{\text{Total Deposits + Total Advances}}{\text{Total number of employees}} \times 100$$

8.4.7 TECHNOLOGY RATIOS

We have developed technology ratio in a simple manner. The number of fully computerised branches has been divided by total number of branches of the concerned bank and thereafter it is multiplied by 100 to arrive at the ratio of computerised branches to total branches, which has been termed as technology ratio. It represents receptivity of the bank to the latest technological changes and also its initiative to provide best customer service and designing a proper information system at the bank for credit appraisal and also as a control mechanism.

$$\textbf{Technology Ratio} = \frac{\text{Total No. of computerised branches}}{\text{Total number of branches}} \times 100$$

8.4.8 EFFICIENCY RATIOS

Efficiency ratios are represented in several ways e.g. net profit to total asset. It is also known as return on assets (ROA) but this ratio has already been included under the head profitability ratio. Similarly, there is a ratio to represent return on equity. The data is arrived at by dividing net profit by total paid up capital and reserves. There is another ratio of total income earned as percentage to total assets. It is known as Assets Utilisation Factor. The later two efficiency ratios, which have been used by us are described below:

$$\textbf{Return on Equity (ROE)} = \frac{\text{Net Profit of the concerned bank}}{\text{Paid-up capital + reserves}} \times 100$$

$$\textbf{Assets Utilisation Factor (AUF)} = \frac{\text{Total Income of the concerned bank}}{\text{Total Assets}} \times 100$$

8.4.9 DIVERSIFICATION BASE

Number of subsidiaries and affiliates in India and abroad are good indicator of diversification of business and as holding company the Bank earns income by way of dividends etc. from subsidiaries and joint ventures. Therefore, number of subsidiaries in India and abroad has been taken by us as diversification base. In a more sophisticated set up, average capital provided by the holding company to the subsidiaries and affiliates can be taken as the diversification base. Another method can also be income earned by the holding company from the subsidiaries by way of dividends etc. divided by capital provided to such subsidiaries by the holding company and multiplying the product by 100.

8.4.10 PRUDENTIAL NORMS RATIOS

Two prudential ratios have been used by us in the model. First is Non-Performing Assets Ratio and

another is Capital Adequacy Ratio. Net NPA ratio to Net Credit reflects health of loan accounts, which are crucial for recycling of finds and also earning income as interest on accrual basis is not booked as income on NPAs. Capital Adequacy Ratio represents solvency of the bank and acts as a cushion against losses. For this reason, Bank Of International Settlements has laid down norms for capital adequacy ratio and at present minimum 8% CAR is stipulated for banks in India. Lower NPAs ratio and higher CRAR are indicators of strength.

$$\textbf{Net NPA Ratio} = \frac{\text{Net Non - Performing Assets of the concerned Bank}}{\text{Net Credit of the concerned Bank}} \times 100$$

$$\textbf{Capital Adequacy Ratio} = \frac{\text{Capital (Tier I + Tier II)}}{\text{Risk-Weighted Assets}} \times 100$$

8.5 PRESENTATION OF THE ABOVE RATIOS BY EQUATION

Preparation of equation facilitates the collation of data, after weightages have been allotted to the parameters. Thus, we reach at a net score representative of the overall performance of the bank. The entire dynamics has, therefore, to be presented by way of an equation. The equation alongwith brief descrption of variables is given below:

8.5.1 SIMPLE EQUATION

$$GS = \sum_{i=1}^{n}[G(i)*P(i)] \div \sum_{i=1}^{n} P(i)$$

where, P (i) = Weightage of the ' i ' th Parameter (depending on the relative importance of the paramater)

G (i) = Grade for the ' i ' th Parameter (based on performance & rank depending thereon)

GS stands for Grade Score and is equal to the sum total of the grades or numerical values assigned to the grades

The above equation signifies flat data for one year .

8.5.2 *EQUATION FOR TIME SERIES DATA*

If Time Series Data has to be presented, the above equation will have firther dimensions and it can be presented in the following manner :

$$\sum_{t=1}^{m}\left[\left\{\sum_{i=1}^{n}\{G(i)*P(i)\}\right\} \div \sum_{i=1}^{n}P(i)\right]/m$$

This equation analyses performance over a period of 'm' years

Time series data in our study is not required because after introduction of the banking sector reforms in India, the position of banks has stabilised from 1996-97. We have, therefore, taken single year data i.e. for the year 1996-97.

8.6 APPLICATION OF THE ABOVE PARAMETERS AND VALUATION NORMS TO THE SELECTED BANKS

We shall now apply actual performance values to the above sixteen ratios / valuation norms as per the data available in the Reserve Bank Of India publications, as the first resource. The second resource is the Annual Reports of the concerned banks. Third resource is Indian Banks' Association publications. This will ensure objectivity and authenticity to the exercise.

In all 16 parameters have been devised for all the banks. These standards represent different dimensions i.e. network of branches in India and in foreign countries, market share of deposits and advances, interest spread, non-interest income, intermediation cost, gross profits, net profits, business per employee, assets utilisation factor, return on equity, computerisation of branches, number of subsidiaries in India and abroad, net non-performing assets and capital adequacy ratio. Thus endeavour has been made to maintain a balance so that a fairly balanced score is obtained. Additions or deletions can be made according to the exercise proposed to be undertaken.

The entire exercise runs into three stages. In the first stage, we shall apply the actual peformance data of the selected banks to the identified parameters (A) to decide their rank for each parameter. In the second stage, we have assigned weightages to the resepective parameters and in the third stage, calculation has been done to arrive at the bank's net score. Weightages have been assigned on the basis of the relative importance of the parameter. For example, highest weight has been assigned to the Net Profit Ratio as it is the most crucial factor for the viability of the banks. The second highest weightage has been allotted to Technology

Ratio and Diversification Ratio in view of their importance in the present scenario where application of technology and diversification are crucial. Weightages assigned to each parameter are given in the following table:

Table ' A ' **Parameters / Ratios with actual performance of selected Banks 3**

Ratios / Valuation Standards	State Bank Of India Performance	Bank Of India Performance	Oriental Bank Of Commerce Performance
1.Network of Branches in India	8,888	2,475	755
2.Network of Foreign Branches	52	18	--
3.Market Share of Domestic Deposits %	20.5	4.9	2.0
4.Market share of Advances in India %	22.2	5.8	1.9
5.Interest Spread Ratio %	3.43	3.21	3.89
6.Non-Interest Income Ratio %	1.69	1.29	0.90
7.Intermediation Cost Ratio %	2.94	2.77	2.19
8.Gross Profit Ratio %	2.17	1.53	2.60
9.Net Profit Ratio %	0.85	0.95	1.56
10.Business Per Employee (Rs. in lac)	56	68	130
11.Technology Ratio %	7.6	8.4	3.4
12. Assets Utilisation Factor %	11.2	10.6	11.7
13. Return On Equity%	16.67	26.81	20.40
14. Diversification Base	20	9	--
15. Net NPAs Ratio	7.30	6.52	5.64
16. Capital Adequacy Ratio	12.17	10.25	17.50

8.7 GRADE SCORES ALLOTTED TO BANKS

In the following exercise we shall apply grades to the concerned banks on the basis of the above relative performance in the following table. The Parameter Weightages P(i) are also given. Grade A=10 points , Grade B=8 and Grade C=6 .

SOURCES:

3. The above data has been primarily taken from Reserve Bank Of India, Report on Trend and Progress of Banking in India, 1996-97 (July-June), RBI and is based on calculations on total assets basis and may vary from the data of the Annual Reports of State Bank Of India, Bank Of India & Oriental Bank Of Commerce 1996-97, wherever it is based on average assets basis.

Table 'B' Grading on the basis of relative performance (rank) of selected banks In March 1997

Ratios / Valuation Standards	Parameter Weightage P(i)	State Bank Of India Performance		Bank Of India Performance		Oriental Bank Of Commerce Performance	
		G(i)	G(i)*P(i)	G(i)	G(i)*P(i)	G(i)	G(i)*P(i)
1.Network of Branches in India	10	A	100	B	80	C	60
2. Network of Foreign Branches	10	A	100	B	80	C	60
3. Market Share of Domestic Deposits	10	A	100	B	80	C	60
4. Market share of Advances in India	10	A	100	B	80	C	60
5. Interest Spread Ratio	11	B	88	C	66	A	110
6. Non-Interest Income Ratio	11	A	110	B	88	C	66
7.Intermediation Cost Ratio	11	C	66	B	88	A	110
8. Gross Profit Ratio	10	B	80	C	60	A	100
9. Net Profit Ratio	14	C	84	B	112	A	140
10.Business Per Employee (Rs. in lac)	10	C	60	B	80	A	100
11.Technology Ratio	13	B	104	A	130	C	78
12. Assets Utilisation Factor	10	B	80	C	60	A	100
13. Return On Equity	10	C	60	A	100	B	80
14. Diversification Base	13	A	130	B	104	C	78
15. Net NPAs Ratio	12	C	72	B	96	A	120
16. Capital Adequacy Ratio	11	B	88	C	66	A	110
Total	176		1422		1370		1432

On the basis of the above equation, the Net Score of the Banks out of a total of 10 stands out to be

S.B.I. = 1422 / 176 = 8.08
B.O.I.= 1370 / 176 = 7.78
O.B.C.= 1432 / 176= 8.14

8.8 INTERPRETATIONS AND ASSIGNING OF NUMERICAL VALUES

The following two interpretations can be made in respect of the above gradation exercise :

(i) On the basis of the maximum score achieved by Oriental Bank Of Commerce i.e 8.14, it can be deemed to be the best performer followed by State Bank Of India 8.08 score. A large base of total assets has neutralised the high absolute values of different parameters for SBI but high value of assets holds the key for future. Bank Of India is not far behind and has a score of 7.78 and possesses the potential of being forerunner in the near future.

(ii) It is true that a few factors like the number of branches in India and abroad, market share and the number of subsidiaries are a matter of performance stretching over a period of time and it may not be easy to catch on those position of large banks by small or even small size banks. But ratios have been chosen in such a manner that each size of bank is graded with the other size of bank without any distortion. It is for this reason of balanced judgement that a small sized bank has maximum score to its side. Disadvantage of small size, medium size or big size on some parameter is counter-balanced by the other parameter. Ultimately it is the performance and not the size that matters.

(iii) Another significant point is the basis on which the year 1996-97 has been chosen in this exercise and why not a time series data has been taken. We have examined this aspect and do agree that time series data neutralises advantages or disadvantages of a specific year and makes the scheme more balanced. But here point to be reckoned is that after financial sector reforms, banks had to undertake the exercise required under the prudential norms and the most crucial was income recognition and assets classification and several banks net results went into red after the reforms. It has been in fitness of things to provide stabilisation time and to choose the year 1996-97.

8.9 SWOT ANALYSIS OF THE SELECTED BANKS

After conducting the exercise of the efficiency model, it becomes significant to conduct SWOT analysis of the selected banks so that they can be benefited by the exercise and may evolve suitable

strategies. We have, therefore prepared the following table containing the comparative position and our suggestions. As SWOT analysis is more an introspective exercise, the banks have themselves to identify their weak and strong points from the following parameters and take such action as is considered necessary by them.

SWOT Analysis of Oriental Bank Of Commerce, Bank Of India & State Bank Of India

Particulars	Oriental Bank Of Commerce	Bank Of India	State Bank Of India	Our suggestions
@ % Growth in deposits	35.9	18.1	18.7	Greater application of computers, excellence in customer service, marketing of the services, product innovation and meeting the competitive edge will be useful exercise.
@Market share in deposits	2.0	4.9	20.5	Special emphasis be laid on increasing market share of deposits because it is the test of meeting the competitive edge and growth.
% of demand deposits	32	36	42	OBC has to make special efforts for raising demand deposits, which are low cost deposits.
@ % increase in advances	35.4	22.4	16.9	Diversification of lending depending upon the expertise and area of consumer finance may be explored.
Market share in advances	22.2	5.8	1.9	While doing the business budget exercise, market share analysis will be of great help so that it is enhanced over a period of time.
Net Interest Income (Interest Spread Ratio) to Total Assets	3.89	3.21	3.43	Containing NPAs, fixing profitable and competitive interest rates for increasing yield on advances, the strategies for increasing advances stated above, mobilising low cost deposits and efficient management of investment portfolios may be some strategies for enhancing net interest income.
Non-Interest Income Ratio to Working Funds *	0.90	1.29	1.69	Non-Fund based business like bank guarantees & letter of credit, leasing and enhancing remittance business can help enhancing non-interest income. OBC will have to make special efforts.
Intermediation Cost Ratio to Total Assets *	2.19	2.77	2.94	Wages and staff strength are most important factors in intermediation cost and as such enhancing productivity is the desired approach for BOI and SBI.
Gross Profit Ratio to Total Assets *	2.60	1.53	2.17	The strategies stated above with special attention on reducing NPAs and booking profitable business will enhance GPR.

Particulars	Oriental Bank Of Commerce	Bank Of India	State Bank Of India	Our suggestions
Net Profit Ratio to Total Assets *	1.56	0.95	0.85	As stated above
Net Profit Per Employee * (Rs. in lac)	1.33	0.68	0.56	For SBI, net profit per employee has improved to Rs. 0.77 lac in March 1998. While fixing budgetary targets, productivity goals be also assigned to branches.
Business Per Employee *	130	68	56	Banks will have to segregate high value accounts for providing specialised services.
Capital Adequacy Ratio *	17.5	10.26	12.17	Containing NPAs is crucial for maintaining a reasonably improving CAR. SBI CAR has improved to 14.58% in March 1998.
Net NPAs to Net Credit *	5.64	6.52	7.3	Effective credit management, NPA Reduction Budget, identifying, hedging and managing are essential to bring NPAs to a level below 5%. SBI has succeeded in reducing its NPA ratio to 6.07% in March 1998.
Priority Sector Lendings %	42	44	38	While achieving the target, the thrust should be on financing the viable proposals with post-sanction follow up to ensure proper end use of funds.
Credit-Deposit Ratio %	48.6	57.4	59.7	CD Ratio analysis is important to plan utilisation of resources for lending, which is a profitable function of banks. A balance between risk and yield has to be maintained.
Fully computerised branches %	3.4	8.4	7.6	Computerised branches are a great resource for customer service and business development. It requires cost-benefit exercise and planning.
No. of subsidiaries & Jt. Ventures	---	9	20	Need for subsidiaries is to be examined in the light of business potential and whether a separate establishment will be viable.

@ Average annual increase during March 1992-March 1997 * As in March 1997

It will be observed from the above that despite having smaller network of branches with no branch abroad, lesser market share, lesser number of computerised branches and no subsidiaries / joint ventures, Oriental Bank Of Commerce has strong points in the shape of profitability ratios, productivity ratios and prudential norms ratios. State Bank Of India possesses strong points in the shape of largest network of branches in India and abroad, largest number of subsidiaries and joint ventures, largest share of deposits with

higher proportion of low cost deposits, largest share of advances, and largest number of computerised branches. Bank Of India is also has its strong points in technology adoption and diversification.

8.9 CONCLUSION

While concluding , we may mention here that all the three banks have performed really well in the post-reforms phase and they have emerged stronger. Their approach is balanced and they have realised fully well that profit with growth is their objective. The above grade scores are only tools of analysis and the results do not cast any reflection on banks. Each bank possesses as much strength as any other bank and they do have a prosperous and bright future ahead as they have the strength to meet the future challenges arising out of competition, deregulation and globalisation.

CHAPTER IX

BANKING IN THE NEXT MILLENNIUM

Chapter IX

BANKING IN THE NEXT MILLENNIUM

9.1 INTRODUCTION

For reaching the stage of 21 st Century banking , the banking sector has traversed a long journey. In recent times starting with the work of Gurley and Shaw 1 in 1960, unitary theories of ' Supply Leading Phenomenon ' (H.T. Patrick 1966) , 2 ' Demand Following Phenomenon ' (Arthur Lewis 1970) 3 leading to its interactive postulate have proved that financial sector and real sector are intertwined and symbiotic. Goldsmithian 'financial super structure' (1969) 4 gave it a new recognition. Mckinnon and Shaw (1973) 5 spearheaded the 'Liberalist School' of thought. Liberalists pleading for market mechanism was based on the premise that financial system and banks had attained required maturity. The objective was restoration of market mechanism and through this devise a natural function of demand and supply and the consequent pricing of assets was expected to speed up financial sector development leading to the development of the real sectors of the economy. It is true that financial sector reforms did not succeed in a few countries like Chile, Argentina and Uruguay but it was not the fault of the financial system. The improper sequencing of the reforms, absence of macro-economic setting, prudential measures and structural reforms in other sectors like industry and trade were the root cause.

The above background reflects that there was a stage, which warranted proof to establish that financial sector plays a crucial role in economic development of the country. But the aforesaid and subsequent developments comprising of the theoretical, empirical (Gurley mid 1960s, 6 Wallich 1969, 7 Goldsmith 1966 and 1969 8 and Fry 1988 9) and causality studies (Jung 1986), 10 including latest experience of the Indian economy (Causality Study of Ray and Bose, 1997) 11 are ample proof of the close link between growth of financial sector and economic development. The spread of financial institutions meets core needs of the economy like pooling of resources from the surplus units, allocation of credit to the deficit units, transfer of economic resources across distance, facilitating payments mechanism and clearing system of financial instruments, managing risk by diversifying and hedging and integration of the world economy facilitated by revolutionary development of computers and tele-communication services. Financial institutions, specially the banks also play a catalytic role by creating credit in anticipation of savings and it gives push to production. The financial institutions, specially banks, do useful transformation mechanism like liability- asset transformation (mobilisation of savings of surplus units and channelising them to the deficit units), size transformation (consortium advances are a unique example), maturity transformation (deposits and advances of different tenors), risk transformation (by

SOURCES:
1 to 11. Ibid.

diversification and their expertise) and thus they meet the needs of the savers and investors. Thus savings-income ratio increases and it is known as direct institutional effect on savings. This is supported by economists like Irma, Adelman, Cynthia Morris (1967), 12 Lewis (1970) 13 and Maxwell J. Fry (1988) 14. Prof. P.N. Mehrotra (1979) 15 asserted in his research paper that financial institutions strengthen significantly the saving-investment process in the economy.

9.2 DIVERSIFICATION IN BANKING SECTOR

Banking sector all over the world has undergone a silent revolution in the 20th century. From the conventional banking of the financial intermediation, which normally encompasses acceptance and pooling of deposits from surplus units and lending to deficit units, rapid changes took place in the arena of commercial banking towards the middle and end of the 20th century. The off-balance sheet items started increasing like issuance of bank guarantees and letter of credit etc. as these functions have ample potential for increasing non-interest income. The expansion of activities of banking sector continued and became so diversified that the concept of ' universal banking ' emerged in United States Of America and has spread to different parts of the world including India. The concept of 'universal banking' 16 denotes that financial sector has to undertake a host of financial services. The banks, which were hithertofore, concentrating on working capital needs of the borrowers have increased their horizon and extend term loans even for longer maturities and for larger amounts. These developments may lead to greater overlap of products and services offered by banks, specialised financial institutions, non-banking financial intermediaries but these are good developments for the economy as they will increase availability of funds and will accelerate competition.

Not only that competition will be forthcoming from the different groups of financial institutions but it will also be more intense due to arrival of new players in the same group e.g. new private banks and foreign banks in the Indian context. With the integration of financial markets, effects of money market and capital market is more marked on credit market. Moreover, capital market gives good opportunities for investment especially when it is buoyant. In India, this phenomenon was witnessed with the advent of financial sector reforms in 1991-92 and new capital issues were at its peak in 1994-95 attracting investment from small investors and it competed with bank deposits. But growth of capital market gives positive signal for growth of the economy and also for the banking sector for two reasons; first that

SOURCES:

12 to 15 . Ibid.

16. The Working Group for Harmonising the Role and Operations of Development Financial Institutions (DFIs) and Banks under the Chairmanship of Sri S.H.Khan has recommended in its Report dated April 24, 1998 that there is need to move progressively towards universal banking in the emerging environment.

In America, the 1933 Glass - Steagall Act, which hitherto segregated commercial and investment banking, is being suitably amended to accommodate universal banking practices.

credit to corporate sector by banks requires equity base for companies, which can be raised from capital market and second, banks perform various roles in the new issues in the capacity of merchant bankers. Even going beyond the realm of working capital finance and long term finance, which only involves greater degree of maturity transformation, banks or their subsidiaries have also undertaken the functions of merchant banking, venture capital and factoring and they are also exploring the field of infra-structure financing, leasing and insurance related business. These opportunities alongwith innovations and diversification of banking services due to application of computers and information tehnology have been analysed below.

9.2.1 INFRASTRUCTURE FINANCING

Infrastructure financing will be an important challenging area for banks in future. It will involve high value projects and banks' commitment will be for longer period of time. It will include core industries sector comprising of power generation, telecommunication, oil and refinery products, petrochemicals, roads and ports. Being a new area with higher risk exposure and technicalities involved, skills of processing the high value proposals will have to be built up. Moreover, involvement of funds for long duration, may create asset-liability mismatches and as such suitable mechanism for asset-liability management with some institutional arrangement for liquidity support will have to be developed. State Bank Of India, being a pioneer in several banking propositions, has taken a lead and constituted Project Finance Strategic Business Unit for funding high value projects in infrastructure and core sector industries. The initial response is excellent. Such financing will increase credit offtake and will be crucial for economic development of the country. Infrastructure financing is not only limited within the country because the thrust of Indian corporates has also been on infrastructure projects of less developed countries funded by multilateral agencies and State Bank Of India is pioneer in this field too and it has supported 40 projects of export finance in 21 countries. 17

9.3 INFORMATION TECHNOLOGY AND COMPUTERISATION

Technology and innovations have always been the hallmarks of progress and they will play a crucial role in 21st century banking. Joseph Schumpeter stressed it much earlier, when he defined 'profit as a reward for innovations to the entrepreneurs'. 18 But full ramifications of the term ' innovations' are seen today in the age of information technology and still greater is in store of the next century. Computer has been one of the greatest innovations of the 20th century. In their pursuit of growth and profitability, banks must become efficiency conscious. Efficiency demands use of modern information technology and computers. Information is a critical corporate resource. Timely, accurate and organised information has become a basic input for decision taking. In a multi-product service industry like banks, which has

SOURCES:

17. State Bank Of India, Annual Report 1997-98

18. Ibid.

undergone phenomenal expansion in terms of functional and geographic expansion, use of computers for monitoring and control is a pre-requisite.

Customers have become demanding. The urban and metropolitan customers and also the commercial and institutional customers demand quicker and better services. The range and size of products have become larger and more complex. Coupled with this is the urgency for innovating new products to meet competition. In India, Second Rangarajan Committee on Bank computerisation (1989) 19 had rightly observed that the challenges facing the banking industry can be met only by taking a long term view towards technology and in view of the multi-faceted character of banking and wide difference in the type, segment and expectations of customers, differential approach towards computerisation of branches is required. It is observed that the purpose of computerisation of banking industry is fourfold : (a) improving customer service , (b) improving housekeeping, (c) improving decision making and (d) improving productivity and profitability of banks. The Committee observed that productivity / profitability of banks can be improved by optimum use of resources viz. funds, equipment and manpower. Computer and communication technology can help to achieve such optimisation. The recommendations of the above Committees presented the blueprint of application of computers and information technology in India.

Information technology has revolutionised banking all over the world and banks are traversing from the age of ' actual banking ' to the stage of ' virtual banking .' It was not long ago that customer's visit to the bank was a must for transacting the business, which entails element of risk too. But automated teller machines (ATMs) removed the above compulsion and led to the phase of ' 24 hours and 365 days banking.' But that was not enough. Tele-banking was an innovation and certain telephonic instructions became acceptable banking propositions.

Coupled with information technology, computers broke all barriers and paved the way for banking being transacted from a distant place through networking of computers. Full perceptible advantages of computerisation have yet to visible in Indian banking like their counterparts abroad but log in facility by networking of computers has been provided to a few selected customers for certain specified banking activities. It is true that the latest banking services like ATMS, tele-banking and networking of computers are available to only a very small fraction of the total number of customers but what matters is that a great beginning has been made and it will change the shape of future banking. Dr. Rangarajan has correctly described the impact by saying, " The one sector that has undergone fundamental change as a consequence of application of information technology has been banking. Availability of technology has radically altered the traditional way of banking. To understand this paradigm shift, one has to look at the banking scenario in developed economies. Increasingly, the customers in the retail sector are doing their business with their banks from the comfortable confines of their homes or offices. Customers can view the accounts, get the account statements, transfer funds, purchase drafts by just making a few punches.

SOURCES:

19. Report of the Committee on Computerisation of Banks (1989), under the Chairmanship of Dr. C. Rangarajan, Reserve Bank Of India

Availability of ATMS and plastic cards to a large extent avoid customers going to branch premises for cash. Cards with an embedded micro -processor chip, also called smart cards, are adding a new dimension to the scenario. Now it is possible to use the processing capability of the chip to securely store information." 20 These smart cards are becoming like electronic purses and not only obviate the need carrying cash but cheque book will also not be required all the time. The smart card will serve the purpose.

" Indeed, opportunities loom large for banks that are nimble and creative" observes Bill Gates. 21 "Information technology offers a chance for banks to build new systems that address a wide range of customers needs including many that can not be imagined today... Electronic delivery of services will allow data to be gathered and analysed. Marketeers will catalogue not just what financial products were bought, but when customers lost interest in the sale cycle. Interactivity will give customers an opportunity to register their preferences, actually steering the development of new products. Good ideas will be fine tuned. Bad ideas will be withdrawn rapidly." Thus computers give greater and specific details with faster speed and for planners in the bank, it helps product development and innovation. Analysis of customer choices and preferences gives an insight for designing and reviewing the array of financial assets.

But providing computers at branches / offices is not enough. While adopting computerisation, the following issues require closer attention:

(i) Automation in banks increases total and also average intermediation cost but lowers marginal cost. Thus *the opportunities for potential economies of scale increase and installation of computers* is useful if it contributes to a planned expansion of business . Advanced Teller Machines(ATMs) involve large investment. Therefore, cost-benefit exercise must be done and the desirability of sharing system can also be examined. Sharing the electronic banking devices is possible through networking of the system.

(ii) The staff has also to be effectively deployed to increase productivity and profitability. The banks have to monitor the increase in the market share in that area due to computer-edge at the particular branch.

(iii) The banks have to take precautions of the situations when computer goes down due to unexpected events like fire and flood etc., which is known as 'disaster planning.' In addition to it, back-up systems will be required to take care of power failure, which, at times, is frequent.

SOURCES:

20. Excerpts from the inaugural address made by Dr. C. Rangarajan, the then Governor, Reserve Bank Of India, made at State Bank Institute Of Information and Communication Management (SBIICM), Hyderabad on 6th July 1996

21. " Get On-Line to Get Ahead ", Bill Gates , The Banker, January 1996 , pp. 12-13

(iv) Steps for data security are also required for saving the data from being destroyed or being misused. This will instil confidence in the customers to the new devices and will also safegaurd interest of the banks.

(v) Application of information technology and computers should not take away the 'personal touch' of bankers because afterall banking industry is a service industry and customer contact is important. Mechanisation is needed to perform the repetitive work but the customer must feel that he is being cared by the bank staff so that the valuable customers relations, which the banks have built-up over decades (also popularly known as 'relationship banking') are not only maintained but also flourish with greater availability of time (spared due to use of technology) for developmental work.

Thus computerisation holds the key for future banking. Success of computerisation will depend on its planned implementation. From the initial stage of ergonomic and easy to use services through computers, the next phase would be ubiquitous services (product and services made available at the convenience of customer).

9.4 GLOBALISATION OF BANKING

Continuous growth of banking with liberal approach and easing of restrictions on foreign trade has promoted globalisation. The traditional foreign exchange business of banks includes handling of export finance, processing of remittances, collection of foreign exchange instruments and handling of import bills and import letters of credit. Banks in the liberalised economies also started exploring availability of low cost funds in other countries for lending at higher rates. But forex transactions involve some extra risk and these risks having not been properly managed led to serious foreign currency crisis in some South East Asian countries in our neighbourhood viz. Thailand, Phillipines, Malaysia, South Korea and Indonesia due to several factors like non-hedging of their foreign exchange liabilities, ballooning of current account deficit, fragility of the financial system with high levels of non-performing assets and under-regulation of the banking sector. These factors led to serious crisis and reflected in sharp decline in currency value, crash of stock markets, collapsing of over-extended companies. Thus globalisation is not an unmixed blessing. With the integration of economies on a global basis, the problems in a country or a group of countries spreads to other countries. This highlights the need of proper regulatory framework and high degree of skill to reap the fruits of globalisation.

The greatest event of the century i.e. launch of Single European Currency '**EURO**' would produce vast changes in the international financial system. The novel exercise of 15 European countries will attract Indian exporters and Indian banks. The cost incurred by Indian banks in hedging against foreign currency risks will be quite minimised and this exercise will be simpler when dealing in one currency instead of 15 currencies.

9.5 GROWTH OF FINANCIAL ASSETS / PRODUCTS

With the growth of banking sector, the array of financial assets has grown and their range will continue to grow due to competition and consumer demand backed by computerisation.. Their classification lies in the basic characteristics like liquidity, marketability, transferability, maturity period, tax status, transaction cost and options. Several new instruments / services like CDs, CPs , securitised debts, financial futures, forfaiting, derivatives, options, merchant banking, factoring, venture capital and leasing have come / will be coming to the financial market. The financial instruments like Certificate of deposits and commercial paper are money market instruments. Commercial papers had their genesis in USA in early 19th century and a highly rated company could raise finance at a lower of interest. It is a window for short term funds for the corporate sector. Like CPs, certificate of deposits (CDs) also originated in USA and these are high cost bulk deposits raised by banks. The instruments like securtised debts, financial futures, options and derivatives are meant for hedging risk. FORFAITING helps the exporter enabling him to convert his credit sales into cash sales by discounting his receivables with an agency called FORFAITER with no recourse to the exporter or his banker. It is a financial tool as well as an important risk management tool with great potential for future.

In their search for fee based business, merchant banking activities of banks will increase and they will undertake the activities like handling of public issues, advising companies in the matters of corporate restructuring, corporate counselling and syndication of loans etc. Factoring refers to management of receivables by a financial intermediary (factor) for a fee. The main purpose of venture capital financing is to exploit advanced technologies and turn them into commercially viable propositions. Venture capital has played an important role in the growth of America's high technology industries and has a great potential in India due to increasing role of technological innovations but it will be a total contrast from the conventional security-based lending. Banks will be required to enlist the help of established technical agencies to get the techno-economic feasibility of the projects examined. Leasing of costly equipments to the top corporates is another area attracting some of the banks possessing core competencies in this field. Element of competition will be limited to the big players and rate of return will be higher.

Banking sector reforms in India , by promoting deregulation and liberalisation have, no doubt, provided opportunities but the changed set up is full of challenges e.g. the new services like factoring, venture capital, syndication of loans and leasing will expose the banks to greater risks. The new array of assets will require expertise in assets and liabilities management and risk management. Deregulation of interest rate also requires expertise to determine interest rates which are remunerative and at the same time competitive. New players like foreign banks and new private banks will intensify competition among banks. This brings to the fore the urgent need of development of the required specialities for the business of banking in the next century. These techniques and competencies have been examined, in detail, in the subsequent paragraphs.

9.6 REQUIRED COMPETENCIES AND TECHNIQUES

9.6.1 ASSET - LIABILITY MANAGEMENT (ALM)

Long term financing involving large amout will add to the relevance of Asset-Liability Management. Asset Liability Management (ALM) concept originated in USA and Canada in 1970s due to volatility in financial markets and inflationary tendencies. ALM is also referred to as total balance sheet management because it is an integrated approach and both sides of the balance sheet have to be managed. ALM is also known as finds management. Funds management looks at banking function as an integrated operation of hiring optimal amount of finds from best mix of sources and simultaneously deploying them into best mix of uses. 22

In the Indian context, banking sector reforms have led to far reaching changes and greater degree of de-regulation of interest rates is one of them. An administered set up of interest rates has both its positive and negative effects. The advantage is that management of assets-liabilities dynamics is less complicated because of administered interest rate regime by the central bank. Deregulation or even partial deregulation brings in its wake complexities as interest rates have to be determined by the banks themselves, which requires costing and pricing skills, analysis of demand and supply of finds in the market and rates offered by the competitors in the market so that interest rate is both remunerative and competitive. With the level playing field and existing and new competitors, banks have to be more cautious, alert and skilled to properly handle the new situation.

ALM is not a one time exercise but it is a continuous process. It involves a careful study of the variables under both the heads of the balance sheet. Under the liabilities side composition, cost and maturity of liabilities are crucial. Bank deposits are most important sources of finds and have a dominant role in liabilities side. Current deposits do not involve payment of interest but they are payable on demand. Savings bank deposits involve payment of interest but are more stable than current account. Term deposits are most stable but involve higher cost. In addition to term deposits, there are Certificate of Deposits (CDs), but these involve much higher interest of rate and as such cost-benefit analysis is essential before tapping such deposits.

What is required is to attain a proper mix of demand and time deposits. The 'core' and 'fluctuating' portion of deposits have to be segregated. This can be done with the help of analysis of past data, the existing environmental factors and future projections. Float finds received in the shape of facilities provided like drafts issue, travellers' cheques issued etc. are also important as they do not

SOURCES:

22. " Asset / Liability Management ", Baker J.B. , Banking I- V, June to October 1978

involve interest cost and funds can be utilised by the banks till such time that these are encashed. The period and amount of float funds for which these will be held with the bank has also to be assessed with the help of the past trends and experience.

The other side of the balance sheet i.e. assets side also requires proper study. Running accounts like cash credit and overdraft require proper analysis of the trend of utilisation of the credit limits in the matching exercise. Term loans, which have fixed repayment instalments payable over a specified period of time can be better planned from ALM angle. In case of advances, there is a trade off between risk and return. Bank's expertise, experience and market report play an important role in the lending exercise. But banks have to guard against riskier lendings. Against this backdrop, a point was made that that after introduction of Income Recognition and Assets Classification (IRAC) norms, banks were extra cautious in respect of fresh lending for fear of creating fresh NPAs. But there is nothing like risk avoidance and banks have to take appropriate risk through extension of credit which is vital to the growth and stability of the economy. Risk is an unavoidable part of banking...... Eliminating risk is not possible; managing risk is." 23

9.6.2 INVESTMENT MANAGEMENT IN BANKS

Investment portfolios have emerged as an important avenue of investment by banks. Earlier with lower rate of interest on Government securities and underdeveloped Government securities market, treasury operations departments of banks were functioning as compliance centres of statutory liquidity ratio (SLR) but now the position having changed with interest rates on Government securities becoming more market related and G overnment securities market having developed, the above departments should function as profit centres. There is an inter-relation between maturity period and interest income of securities. Short dated securities fetch lower interest rate and long dated securities attract higher interest income. Shares and securities of corporate sector involve higher risk, whereas Government securities do not involve risk and also qualify for statutory reserve requirement ratio.

The banks have also to classify, as per Reserve Bank Of India guidelines, the portfolio of approved securities into ' current ' and ' permanent ' category. The securities, which are classified as 'permanent' are to be held by the bank till maturity and hence these securities can not be used for trading purposes. Moreover, the international practice is to mark all the investments to market. In India, mark-to-market proportion of approved securities was enhanced to 50% for the accounting year 1996-97 and to 60% for the year 1997-98. Marking-to-market is also known as market-value-accounting. Thus with growing investment opportunities, the scene has becomes more complex. The maturity pattern of assets and liabilities can be matched by preparing maturity baskets for specified period. Maturity, yield, composition of securities and directives of the central bank are the guiding factors for investment

SOURCES:

23 " COMMERCIAL LENDING ", Ruth Gorge.E , *American Bankers' Association, Washington* DC USA 1995

management by banks and the need is that they should not function merely as ' compliance centres ' but as 'profit centres' as well.

9.6.3 LIQUIDITY MANAGEMENT BY BANKS

Lnked with ALM is liquidity management. The essence of banker customer relationship is an undertaking on the part of the bank to provide customers with cash on demand or after a stated period depending on the nature of the deposit. One of the purposes of reserve requirements is to ensure liquidity. Cash is most liquid of bank's assets but it does not earn income. Banks, therefore, manage with fine cash balance ensuring at the same time that Cash Reserve Requirements are fulfilled. But liquidity management is not only managing the cash. It also has a broader connotation. It essentially means ability to meet all the contractual obligations as and when they arise, as well as the ability to satisfy funds requirements to meet new business opportunities. A fast growing bank requires greater care to guard against mismatch in sources of funds and its uses. Effective liquidity management will save the bank from heavy dependence on money market sources of funds on high interest rates.

9.6.4 RISK MANAGEMENT

Risk management will assume greater significance. Banks have to manage several types of risks and the important ones are given below:

(i) Credit risks

These are also known as default risks and arise due to non-fulfilment of obligation on the part of the borrower. The economic conditions, market situation, innovations and policy changes etc. may be the possible causes of default or it may be even wilful. A comprehensive credit appraisal making use of market reports and data bank, examination of techno-economic feasibility of the project and proper analysis of financial statements help in management of credit risks. Post-sanction monitoring in the light of market variables and follow-up are also important. In addition to the aforesaid factors, industry-wise exposure limits help in diversification of risk factor.

(ii) Liquidity risks

Liquidity risk is potential inability to generate cash to cope with the decline in deposits or increase in assets. Liquidity risk thus arises due to mismatches in maturity patten of asset and liability. As banks deal with a number of assets and liabilities with varied maturity pattern, the process of matching is complex and expertise of the banker plays an important role. Managing such type of risk is crucial; otherwise, the bank may have to go to money market for short term funds at higher rates of interest.

George E Ruth calls them 'finding risk'. 24 This aspect has also been examined under the head 'Liquidity Management'.

(iii) Interest Rate Risk

Interest rate fluctuations affect banks in a big way. The immediate impact is on interest income and interest spread. These changes also affect the market value of assets and liabilities. These are known as earning sensitivity and price sensitivity to interest rates. In a deregulated set up, interest rates are market determined and may have wider and faster fluctuations due to deregulation and globalisation and as such interest rate risk is higher and has to be effectively managed by proper ALM .

(iv) Foreign Exchange Risk

Foreign exchange is a remunerative area for banks because in addition to the usual earnings, banks gain out of the inbuilt margins in the exchange rates. But forex operations involve additional risks too. The most important is exchange rate risk. The aggregate of sales and purchases in the denominated currency may not match The size of the gap and volatility of exchange rates are deciding factors of the risk. Banks have, therefore, to ensure proper asset-liability management in forex business as well.

9.6.4.1 Identification of risk

There are several ways like market reports, check lists, access to data bank, profile and latest developments in the concerned industry, inspections, operations in accounts etc. to identify the element of risk. The concept of "pools of risk" evolved by Ed Williams requires special mention. It refers to "a series of transactions that have common risk characteristics " Interest risk may be termed as a pool of risk. " Risk assessment is the estimation of size, probability and timing of a potential loss under various scenarios..... The potential loss is generally defined in terms of " frequency " and " severity ." However, credit portfolio being the major asset portfolio of the bank, identification and measurement of risks associated with large corporate borrowers becomes essential. Two broad factors which can affect the performance of a portfolio involving large corporate borrowers will be the industry related volatility and the company related volatility in their operations.

9.6.4.2 Management of risk

Then comes the exercise of management of risk . It covers the following measures:

(i) It should be ensured that the business involves a fair business risk and does not involve adverse

SOURCES:

24. Ibid.

selection. While avoidance of the risk exposure is not possible in banking, it is necessary that the decisions should be well considered. In large exposures, specially in new exposures, Committee approach may be adopted.

(ii) In case of high risk areas involving large amount, opinion of experts / rating agencies may be obtained. Techno-economic feasibility reports may be obtained for large advances or the new areas of financing.

(iii) Risk management instruments are required to cover the risk e.g. in foreign exchange cover operations help in matching the position. Derivatives will have a greater role to play for hedging the risks in future.

(iv) The pricing of the products should ensure that the borrower bears the cost of the risk. Where risk perception is higher, interest rate should be higher. It will necessitate categorising the borrowers under various risk groups. Risk index of the borrowers has to be prepared. 25

In order to properly manage the risks, a system of forecasting may also be devised. Forecasting will involve analysis of relevant factors, which will normally be financial and economic e.g. monetary growth, inflationary tendencies, economic survey of the economy, scanning the growth of output, exports, imports, savings, investment, bank deposits, advances and condition of the global economy.

Regulation of financial markets, especially the risk taking activities of banks, is necessary to preserve public confidence in the banking system. These measures are classified as preventive and protective regulation. One example of preventive regulation is capital adequacy ratio. Deposit insurance provides a protective cover to the depositor. Under this Scheme the target beneficiaries are comparatively small depositors, whose deposits are insured. In India, the level of protection is Rs. 1 lac maximum per depositor. 26

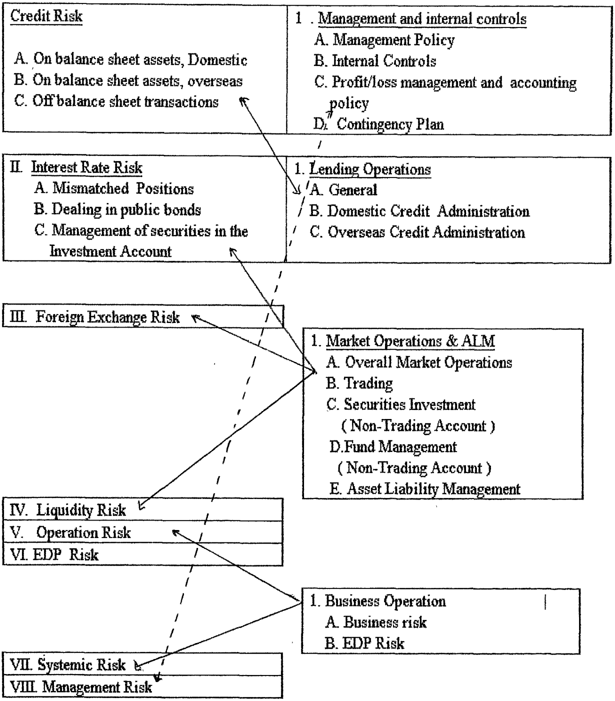
SOURCES:

25Bank Risk Management : A Risk Pricing Model S. RjaGopal, Member of Faculty, College of Agricultural Banking, Reserve Bank Of India, Pune, State Bank Of India Monthly Review, November 1996. He has opined that a model for risk categorisation would involve horizontal and vertical classification of various risks and weightage will have to be assigned to such risks and risk index of the borrowers will have to be prepared. and pricing model will be based on risk rating of the borrowers.

26. In United States the maximum level of protection is $ 1 lac, in France the limit is 4 lac Francs, in Japan 10 lac Yens and it is compulsory in all the aforesaid 3 countries and in India as well. " ECONOMIST " (1996), A Survey of International Banking , page 19

A check list of risk management is given below: 27

Check list of Risk Management



SOURCES:

27 " **Checklist for Risk Management** ", **Bank of Japan , quarterly Bulletin May 1997 pp. 58-91**

Thus risk identification, risk measurement and risk management, preventive and protective regulations are and will be very crucial in times to come because of the complex and fast changing scenario of the banking sector and their profitability will largely depend on their skill and expertise in managing risks.

9.4 Derivatives as a New Product for Managing Risk

Derivatives will be a popular product for hedging risk by banks. The traditional methods of safeguarding against risks are comprehensive loan agreements as a legal remedy, obtention of collateral security and credit portfolio diversification. The methods are useful in varying degrees but they can do not fully protect the creditor. Hence a new product known as 'derivative' has been evolved. Derivatives are recognised as the most cost efficient way of hedging risks in certain types of commercial and financial transactions and, therefore, the countries not providing such globally accepted risk-hedging facilities are at a disadvantage in today's rapidly integrating global economy. Gupta Committee's Report on Derivatives has 28 has recommended introduction of derivative trading along with strict governance.

Derivatives are a recent phenomenon even in developed countries. In India, forward contracts are extensively used for covering currency risk but there are no derivatives available. The major disadvantage with forward is that their contract price is not publicly disclosed and they are not tradable. Derivatives are structured products that derive their value from underlying instrument like stocks, bonds , commodities etc. and are increasingly used to manage risk. Some popular derivatives used in risk management are forwards, futures, swaps and options, which are used for hedging. Futures trading is a more efficient way of hedging risk as they are standardised tradable contracts. While futures and options have many similarities and serve similar purposes, the risk profile of an option contract is asymmetric and they are also more complex. Options are contracts giving the holder the right but not the obligation to buy (known as " call option ") or sell (known as " put option ") a particular asset at a stated price (" strike price "), within a specified period.

9.5 PERFORMANCE BUDGETING AND MONITORING

Banking will require larger degree of financial planning and budgeting. In order to make optimum utilisation of resources with economy in costs accompanied with planned growth and profits, a system of performance budgeting and monitoring (PB &M) has been introduced by several banks and it will gain further acceptaility. The setting of goals for a specific period has to be in conformity with corporate policy of the organisation. "The project or campaign", observes Jannot , 29 "should be organised ideally

SOURCES:

28. Committee on Derivatives Trading in India , L.C. Gupta, Chairman
29. " Improving Bank Profits ", Jannott Paul F., Bankers' Publishing Co. Boston 1984

around a committee of senior officers, with a chairman to direct the committee's effort. Goals should be defined and progress should reported in writing."

The advantage with performance budgeting is that it is both an aggregative and segregative exercise. By this process senior officers at the top and staff at the grassroot level are all involved. Corporate expectations represent aspirations of an individual bank, which distinguishes it from other banks. The budget must take into cognisance the overall economic scenario, the market share of the bank in various segments, the past data also known as historical data and the environmental factors. Based on the aforementioned factors, planning and scheduling exercise is performed. The target for growth rate in various segments and various transactional heads, income generation, cost effectiveness and finally projected profits are arrived at. The important segments comprise of corporate sector, retail and household sector, international banking, small industries, small business and rural sector. The various transactional heads will comprise of deposits and advances under different segments, remittance facilities, bill business, collection facilities, custodial services, foreign exchange business. Non-fund based business like letter of credit and bank guarantees etc. should also form a part of the budgetary exercise. Non-Performing Assets reduction budget should be a part of the overall budget. Budgeting should also be done for the inputs like provision of staff and capital expenses.

Settlement of budget is an important exercise. When properly settled, it will command commitment and acceptability of the all concerned. The targets should be challenging but realistic and should not be imposed on the operating functionaries. While budgeting the crucial factor is that the operations must command viability comprising of optimum earnings with least cost. It should apply to all areas like cost of deposits and operating expenses.

Each branch of the bank handling commercial business should be treated as a profit centre. If a branch is not in a position to generate budgeted profits, it will have to examine alongwith crucial data like market share of business of the bank in that area, performance of other branches of the bank in similar set up, productivity of staff in terms of per employee business at that branch and of course, the past data, environmental factors and future projections. The controller has to monitor such branches so that there is a turnaround within a specified period.

Non-Performing Assets (NPAs) have a substantial impact on branch profits. The progress in reducing NPAs , recovery of bad and doubtful debts and also repayments of principal and interest in respect of standard assets also require adequate attention so that old NPAs are reduced and fresh NPAs are contained.

Monitoring is an important part of performance budgeting. Suitable formats have generally been designed by the banks for this purpose. PERT chart (Project Evaluation and Reviewing Technique) is very useful for this purpose. The important thing is that these should not be filled up as mere statistical returns and should be qualitatively analysed and properly deliberated. Important ratios like cost of deposits, yield on advances, business per employee, interest income and non-interest income should also

be worked out and analysed. In case performance is below the budgeted level or environmental factors have undergone a change, suitable review / corrective action be undertaken.

9.g CUSTOMER SERVICE

With rising customer expectation and competition, banks will lay greater emphasis on excellence in customer service. Customer service in the banking industry is normally perceived as the quality of service rendered by the staff member to the customer during his visit to the branch. But it is much wider term and covers 3 important Ps - PERSON, PRODUCT and PROCESS. The first interaction of the customer takes place in the branch at 'May I help you' counter or the concerned transaction counter. These counter staff, therefore, act as first point of contact and as such they are known in USA as 'front-line persons' (FLIPs). It is essential that FLIPs should possess marketing skills, right attitude and temperament. The first formal link with the customer is established at the time of opening the account. The officer allowing opening of the account may explore this opportunity for cross-selling of bank services.

Superior service is and will continue to be a winning strategy in 21st century banking in India. The reason for high priority to service is that it leads to gains in the market and an edge over the competitors. Excellence in customer satisfaction is a part of 'Mission' of State Bank Of India. Bank Of India 'Mission' is to provide superior, proactive banking services. Other banks too have given top slot to customer service in their 'Mission' statement.Thus excellent customer service will be the mission and culture of all the banks and sincerity to this cause will provide them the opportunities of growth and profit. Being a financial sector organisation, promptness is all the more necessary to save from possible financial loss besides saving avoidable loss of time and energy.

The perception of customers in regard to customer service is important. In a research study conducted by Bank Administration Institute, USA 30 relating to the issue of retail service quality, the ranking of elements in service quality definition was as under :

1. Promptness
2. Professionalism
3. Accuracy
4. Personalisation
5. Courtesy
6. Knowledge
7. Company reputation
8. Consistency
9. Fulfillment of customer needs

SOURCES:

30. " BANK SERVICE QUALITY WORKBOOK - A GUIDE TO IMPROVING QUALITY OF SERVICE ", **Bank Administration Institute (BAI) Illinois 1987, extracts from the Executive Summary**

10.Sales productivity
11. Price/value relationship

The research further identified negative employee attitudes as the most common problem.

Despite the need of good customer service, we find dissatisfied customers. Two factors have aggravated the problem. In the post-nationalisation period, the number of accounts have phenomenally increased in banks. The expectations of customers have also increased and it has led to a mismatch in the two. In an empirical study conducted by Sri B.N. Bhattacharyay in India, it was established that " the unqualified assertion that customer orientation of the banking industry has deteriorated in the post-nationalisation era is empirically untenable. The study also indicated that the banking industry is still predominantly inward-oriented. The need of the hour for the banking industry, given the rising aspiration of customers as well as increasing competition, is to gear itself aggressively to the needs of its customers. This will not only mean developing new services and new instruments to meet the emerging needs of customer, it will also mean rendering the services in an efficient and effective manner. " 31

Work culture requires to be improved. Delays have to be avoided as 'service delayed is service denied.' Courteous behaviour is the basic minimum ingredient of customer service. As a matter of fact, 'courtesy costs nothing but buys everything.' Customer Service Meetings at branches should be activised as they provide a forum to interact with the customers and the customers also get an opportunity to express their problems. Technological upgradation like computerisation can bring accuracy and speed. Banks should go a step ahead of customer service and they should also educate the customers about the various schemes of the bank and also the rights of the customers. An objective assessment of customer satisfaction be got done preparing customer satisfaction index and help of outside agencies can be enlisted for the purpose. The purpose is to achieve excellence in customer service. Michael Quinn and John Humble 32 have developed The PROMPT Service Approach having the following six elements:

(i) Prioritising customer needs : Understanding customer needs must be the starting point and matching company (bank's) capabilities to customer needs is the essence of good strategy.

(ii) Service reliability - Meeting customer's expectations as promised- is a vital element in providing service excellence. Some service industries go to the extent of suggesting that 'we should not only meet but exceed customer satisfaction.'

(iii) Organising for the customers : The customer, not the organisation, is the business.

SOURCES:

31." Is customer service deteriorating in the Indian banking industry ?", Bhattacharya Biswa N., Vikalpa, Ahmedabad, July-September 1990, pp. 23-29
32. " The PROMPT Approach ," Quinn Michael and Humble John , Long Rang Planning, United Kingdom, April 1993 pp. 31 to 40

(iv) Measuring customer satisfaction : Personal contacts and analysis of complaints are most frequently used methods.

(v) Personnel training : *Training in customer service is not a standard product to be bought of the shelf. It must be properly devised and customised.*

(vi) Technology focusing : The investments must have a business focus.

The ' **PROMPT** ' approach has also been represented by the following presentation :

	Prioritise customer needs	
Technology must be focused	Customer	Reliability is the key
People must be trained		Organise for Customers
	Measure Customer Satisfaction	

The ways of improving customer service have been engaging the attention of bankers in Japan, USA., India and other countries as well. Some of these have been discussed below.

9.9.1 TOTAL QUALITY MANAGEMENT

Total Quality Management is an effective system for integrating efforts of both labour and management, which work as a team so as to continually improve quality to achieve maximum customer satisfaction. It seeks to involve human potential through participative management and harnessing every one's creativity and quest for improvement. Quality is adopted as a strategy and a design. Customer service or customer satisfaction is not a means but an end of TQM. "**Quality Circle**" (**Q C**) makes a small but an important beginning towards TQM. QC comprises of a small group of employees in the same work area, who organise on their own volition and identify a problem, analyse its causes and develop its solution. *Brain storming is the first technique and it gives confidence and sense of identity to the group.*

The Japanese concept of **KAIZEN** , which means " ON GOING IMPROVEMENT " also aims at *customer satisfaction. Similarly,* ***Zero Defects*** *concept lays thrust on quality and the objective is doing* the job right at the first time. The concept originated in manufacturing and is now applicable to services sector as well, including banks, where mistakes may be alarming and may lead to financial loss. There is another concept known as " **Recovery**," which is related to a state when the customer is not satisfied and lays emphasis on recognising the customer's perception apologising for the mistake, compensating for the inconvenience and ensuring that it does not recur. **"Benchmarking"** is another concept to achieve excellence by identifying benchmark i.e. the best standard or practice in that field. Then a practical plan is devised to achieve the benchmark. It hinges around ' *3 Ps* ' i.e. *products*, people and *process*. Thus whatever be the theory, quality is the watch-word in the competitive world and it is market-driven and aims at customer satisfaction.

9.$.2 SERVICE-PROFIT LINKAGE

The service-profit combination is assuming importance in the banking. It has been called service-profit chain by Heskett and others. 33 This concept establishes a relationship between profitability, customer loyalty, employee satisfaction and productivity. Customer loyalty means customers maintaining their accounts at a particular bank over a period of time. Customer satisfaction is the factor which binds them with the bank and it is a product of value of services accruing to a customer. Value is created by satisfied, efficient and productive employees; who are, in fact, human capital for an organisation.

There are two concepts for providing better services. " Relationship banking " is also adopted as a selected process. This approach believes in cultivating personalised services with the existing customers so that they place their entire banking business with that bank. It enhances business at a lesser cost because it is cheaper to retain a customer as compared to tapping the business of new customers . It is a synthesis of product, delivery channel and relationship management skills. Personalised service is provided to customers and it enhances customer-friendly image of the bank. Credentials of the existing customers are known and it may provide safety to the banks specially in extending loans at a stage when NPAs are growing. "Transactional banking " is just the reverse of the "relationship banking," as the customer, being more informed and demanding, evaluates cost-benefit of each transaction. With the world getting more commercialised, transactional banking will dominate the scene in the next century and will keep the bankers on their toes for tapping the business. It will be a 'buyer dominated' or to call it 'customer dominated market.'

SOURCES:

33. " Service Profit Chain ", Heskett J. L. , Jones T.O., Lovenian G.W., Sasser Jr. W.E. , Schlesinger L.A. , Harvard Business Review, March-April 1994, pp. 169

9.9.3 *MARKETING OF BANK SERVICES*

It was only during 1960s that the concept of marketing began to catch up in the banks in England and USA and with the passage of time it has become a popular technique. But marketing approach in Indian banking has been slow due to earlier regulated set up and lack of competition in the pre-reforms period. The responsibility on the managers for operations gave them little time for planning. Moreover, most of the developmental activities were confined to deposit mobilisation.

Banking sector reforms have exposed banks to competition and hence the concept of marketing is gaining ground and it will have a greater role to play in the next century. Marketing in any activity is a systematic attempt to reach the customer after identifying his needs so that products can be tailored to meet his requirements. The marketing approach in banking will involve the following :

(1) identifying customers needs and wants,
(ii) *developing appropriate banking services to meet these needs,*
(iii) pricing of the services so developed
(iv) setting up suitable outlets / branches
(v) advertising to promote the services to the existing as well as prospective customers,
(vi) forecasting and marketing research to assess the future financial markets.

Thus from a reactive state of selling bank services, banks will have to reach proactive stage of marketing taking care of, inter alia, market research, brand creation and retention, selling , customer segmentation etc.

9.10 BUSINESS PROCESS RE-ENGINEERING (BPR)

Customer-friendly approach is rule of the day and with this pursuit to be fulfilled by the banks, processes will be redesigned. Process system was created to perform the business efficiently and economically. But processes have become rituals and the managers are so bogged down with processes that the real value addition content of the work is relegated to secondary position- sometimes in the name of work culture and sometimes in the garb of accountability. It is true that banking involves risk but unnecessary processes do not reduce the element of risk.

All work / activities in banks can be classified in three groups :

(i) Value-adding work for which customer is ready to pay.

(ii) Non-value adding work, which creates no value for the customer but is required to get the value adding work done.

(iii) Work which neither adds value nor enables value.

The third category of processes have to be identified and phased out.

Michael Hammer and James Campy define re-engineering as " the fundamental rethinking and radical redesign of business processes to achieve dramatical improvements in critical, contemporary measures of performance, such as cost, quality, service and speed. "34 Michael Hammer has further identified six approaches that can be employed individually or in various combinations as a matter of strategy for better, diversified and innovative customer service:

(i) Intensification : Improving processes to serve current customers better.
(ii) Extension : Using strong processes to enter new markets.
(iii) Augmentation : Expanding processes to provide additional services to current customers.
(iv) Conversion : A process that is performed well by a company is taken up as a service for other companies.
(v) Innovation : Applying well performed processes to create and deliver new goods or services.
(vi) Diversification: Creating new processes to deliver new goods or services

While it may not be possible for banks to radically alter the time tested systems, procedures and processes because they are based on law and practice of banking, yet there is scope for ongoing improvement with changing times. Japan attaches great significance to the suggestions received from every cadre of staff and it gives them opportunity to constantly improve the quality of product and services.Thus processes have to be designed and redesigned by the banks in such a manner that they are customer-friendly, meeting at the same time, the requirement of proper accounting system and responsibilities imposed by law and regulations. Processes should also facilitate expansion, innovation and diversification of services.

9.11 COMPETITION

Banking sector reforms have brought in its wake greater competition. The element of competition has increased with the entry of new private banks and foreign banks. Competition will intensify further in the banking sector all over the world by globalisation of banking. Competition may be of several types:

(i) In administered interest rate regime, there was no avenue for interest rate competition among banks. Such competition was forthcoming from other sectors, which could offer higher interest rates on deposits. With partial and phased deregulation of interest rate, the banks while determining interest rates (including their prime lending rates) have to take into account the competition offered by other banks / financial institutions. Where the customer becomes so calculative that he conducts cost-benefit analysis of each transaction, it leads to ' transactional analysis approach.' Services charges are largely prescribed by

SOURCES:

34. " RE-ENGINEERING THE CORPORATION A MANIFESTO FOR BUSINESS REVOLUTION ", Michael Hammer and James Champy, Nicholas Brealey Publishing, London 1994

Indian Banks' Association for the member banks offering no scope for competition.

(ii) Customers are also conscious about quality of services. A bank providing prompt and courteous service gets a competitive edge. This is a part of their strategy described in banking as 'customer focus.' A dissatisfied customer switches over to another bank and it is termed as 'customer defection.'and it requires serious analysis as it means loss of business to the bank and necessary correctives are required. In order to tide over the above situtions and to create a quality conducive atmosphere, several measures have been initiated by banks for improving quality of services like 'total quality management' (TQM), 'zero defect', 'KAIZEN' and 'bench marking' etc., which have been discussed earlier. Banks will, therefore, gear up their product development departments with schemes of research and development.

(iii) There is a transition from generic schemes to tailor-made schemes for the customers. This is possible due to technological advancements and innovative approach of banks. This is more pronounced in case of high-value customers. Customers show their preference for such services and as such innovative banks will be in a position to tap larger share of business.

(iv) Based on the requirements of specific segments, specialised branches have been opened by banks to provide specialised services efficiently and promptly. Banks develop expertise in certain market segments by taking early lead or developing core competencies in certain niche segments. Such type of competition may be for the segments like corporates, NRIs, consumer finance, high net worth individuals, small scale industries, high-tech agriculture, trade finance, housing finance and retail banking etc. Expertise in those areas gives a competitive edge to the banks. Banks may like to go even for super-specialisation branches like 'Diamond Branch' at Bombay and 'software Branch' at Hyderabad.

(v) Availability of substitutes and facilities of disintermediation intensify competition. For example, investment in capital market offers a good opportunity for investment by the surplus units. Commercial paper adopted by highly rated companies is a disintermediation process. These markets / financial instruments act as competitive force.

Thus consumers of banking services are getting increasingly agile, enlightened, cost and quality conscious, exerting competitive pressure on the banking system. Banks would also like to enter into strategic alliances to have competitive edge over other banks / financial institutions. It will continue to be a matter of crucial importance that banks adopt proper pricing mechanism for their services and rates of interest for deposits and advances to ensure that competitive banking does not become a losing proposition. Rate on interest on advances must include risk factors involved.

9.12 FINANCIAL SERVICES COSTING AND PRICING

Costing and pricing are basic factors in a business and the banks in India will have to provide suitable structure for making it as an ongoing exercise. For banks with large number of branches and several products, it becomes a complicated exercise. The main objective of costing is to ascertain the

present cost of services / activities, analysis of their trends for cost control, pricing of services, cost benefit analysis of services, break even analysis of branches, cost comparisons for macro level policy decisions, customer profitability analysis and profitability study of overall activities like deposits, advances, remittances etc. While devising appropriate pricing system, the following factors require consideration:

(i) Average cost constitutes the rock bottom for the price of services but there are exceptions like subsidised rates for priority sector administered by Reserve Bank Of India. Generally, price should be cost plus normal profits.

(ii) In equilibrium, the value or utility of the financial service to the customer is equal to price paid by him. The primary concern of the bank should, therefore, be to make additions in the value added to the service.

(iii) Sensitivity of the customers to various pricing options may differ. They may be ready to pay a higher price for the faster delivery or electronic services like electronic funds transfer or computerised system of accounts.

(iv) Forces of demand and supply determine the price and same principle applies to banking servies. But banks have limited liberty because the price of service may be subject to some ceiling rate or a signal or reference rate like ' Bank Rate.' Bank can stipulate extra price to be paid for extra services.

(v) Pricing also depends on the type of the market for the product. In an oligopolistic state of market, sellers have an important influence on the price-output policies of other competitors because their number is small. The pre-reforms stage may be compared with oligopolistic state with much lesser competition and the banks enjoyed a higher interest spread but with increasing competition, it has come down.

(vi) A pricing model for bank services must include price for the risk covered. The banks would like to quote rate of interest on advances linked with risk index of the borrower. In economic theory also profit is a reward for 'risk-bearing.'

(vii) An innovative product or a product tailored to meet the specific requirement of a customer will command higher price. This will be governed by the concept of product differentiation. The new areas like leasing, factoring and venture capital will command higher price. Moreover, computerised branches require higher capital outlay and the stationery items used by them are costlier and as such their service charges would be higher and be fixed on realistic basis.

(viii) The best banks would like to select and priortise their products strategically basing them on a detailed analysis of the market niches and trends within those niches. This will give them competitive advantage.

An appropriate pricing system can be used as one of the effective tools for expanding the business, diversifying into new areas, identifying scope economies and business opportunities available. Further, a relatively large size of banking firm is benefitted by the scale economies and is better placed for availing opportunities for diversifying into new areas of business.

9.17 HUMAN RESOURCES

Diversification and computerisation will require more skilled and innovative human resource in the time to come . Human resources are most valuable asset of an organization and are also termed as 'human capital'. The term human capital denotes investment in human resource for his development as a creative and productive resource for achievement of the organisational objectives. Human capital formation is the process of acquiring and increasing the number of persons who have the skills, education and the experience which are critical for an institution. Human capital formation is thus associated with investment in man and his development as a creative and productive resource.

The capabilities of the human resources can be enhanced by better organisation of work, better management techniques and creation of appropriate attitudes. Motivation technique is found to be useful as it leads to a goal-directed behaviour and better performance.Proper reward and recognition schemes in the banks motivate the employees. For increasing the motivation of employees, banks have introduced quality circles, staff suggestion schemes and training system.

Human capital can be formed in several ways. It can be by employing the staff when they are young and may be developed through on-the-job training, in-service programmes for formal training, management development seminars and many other ways. It is also developed in the employment through better organisation of work, creation of appropriate attitudes and incentives and better management of people. The analysis of human capital formation is alike capital formation. In designing a strategy for development, one needs to consider the total stock of human capital required, its rate of accumulation and its commitment to high-priority productive sector. Innovation or the process of change requires strategic human capital.

With the advent of industrial age, knowledge and learning became the new form of capital. But with the globalisation of the economy, computerisation and increased competition, skills and attitude have become equally important. Banks are required to be innovative and create new products. The push to innovation requires a different kind of learning. It goes beyond problem solving and instead focuses on imagining possibilities and creating radically new capabilities. Frank J. Barret 35 terms these competencies as under:

SOURCES:

35" Creating Appreciative Learning Cultures ", Frank J. Barett, Organisational Dynamics (Winter 1995) pp. *36 to 48*

1. Affirmative competence : It focuses on what the organisation has done well in the past and is doing well in the present .

2. Expansive Competence : High performing orgnisations create a vision that challenges their memebers by encouraging them to go beyond the familiar ways of thinking and it stretches into new directions.

3. Generative Competnece : High performing organisations not only develop expansive scripts but they also create integrative systems that allow members to see that their efforts make a difference. The systems include elaborate and timely feedback so that members are able to sense that they are contributing to a meaningful purpose. Appreciative learning systems exhibit a generartive competence.

4. Collaboative competence : Collaborative competence refers to the power of dialogue to transform systems. Appreciative learning cultures create multiple forms of responsiveness, remain accessible to employees and are open to their view points and suggestions.

Thus appreciative learning cultures nurture innovative thinking by fostering an affirmative focus, expansive thinking, a generative sense of meaning and creating collaborating systems.

Japanese approach to HRD : It is true that Japan is experiencing an economic slowdown but the fact remains that they lay stress on the quality aspect through human resource angle. During 1980s, it was quality and speed that helped Japnese firms to gain major share in international markets. The Japnese companies recruit people with right customer approach. Japnese employers pay more attention to the behaviour of their furture employees than their academic background. As with KAIZAN (a continuous improvement) approach, customer satisfaction starts with training. It can be expressed as under : 36

Good Training = Positive Service Attitude = Motivated Employees = Decreased Staff Turnover = Improved Service Quality = Satisifed Customers. For example, Matsushita Electric Industrial states, "We make people first and in addition, we make electrical products." It explains the Company's corporate philosophy and the staff feels totally committed and dedicated.

Training is an important tool to develop required skills and attitudes for achievement of organisational goals. But the old concept of 'job knowledge and 'job content' in training stands changed because training has become more a process of learning and trainers have to play the role of coordinators, facilitators and training consultants. The word learning emphasises self-development and the initiative has to come from the employee and it should involve his active participation. Training has to go beyond

SOURCES:

36. " Japnese Approaches to Customer Satisfaction : Some best practices ," Turpin Dominique V., Long Range Planning , June 1995 , pp. 84 to 90

the menu-driven courses to a new mix of learning methods and workshops. Nurturing self-development does not mean off-the-job from training courses but a change in mindset from training to learning process is required. The changing world of training has been described by Lange 37 as under :

Training Models and new emphasis

Current Model	New Emphasis
1. Understand strategy	1. Helping to create new strategy
2. Identify skills needed	2. Helping create a learning environment and knowledge sharing systems
3.Put in place effective programmes	3. Working with individual's teams to develop skills

The training system in Indian banks is elaborate and extensive. Most of the banks have their staff training centres and some of them have their staff colleges and specialised institutes. While they are generally performing well, there is a need to frame strategies to meet the emerging requirements. The staff is highly educated and banking is no longer a routine banking. The core programmes would need a review and will have to include such areas as assets liabilities management, risk management, quality assurance to customers, product development, corporate identity, credit management, non-performing assets Management, profit planning at branches, modern techniques of auditing, application of computer and information technology and treasury management etc. Research and development must be linked with training system. They may also be assigned with the product innovation. There must be a session of staff suggestion in the selected training programmes.

Training centres should not remain cost centres. Cost of training must be debited to profit centres who depute their staff. For better capacity utilisation, consultancy work may be undertaken for the staff colleges. Training centres of a few banks may be clubbed to make them more economical.

9.14 Safety and Audit Mechanisms

With the increasing risk factors, the banks would devise their own mechanisms of audit of their accounts so that element of error and frauds is minimised. Banks have their in-house audit teams besides controls exercised by Reserve Bank Of India. The RBI supervisory strategy now consists of both off-site and on-site surveillance. As regards on-site inspection, the focus is now on the evaluation of the total operations and performance of the banks under the **CAMELS System**, which has been adopted from the cycle of inspections commencing from July 1997:

SOURCES:

37. " The Changing World of Training ," Lange Mathew De, Banking of Financial Training, February 1996 pp.6-9

CCapitalAdequacy
A:AssetsQuality
M:Management
E:Earnings
L:Liquidity
S:Systems and procedures

CAMEL Rating Model had its origin in USA, where the Supervisory Authorities used it for supervision over financial institutions. In India, there is an improvement in the above system as systems and procedures concept has been added to it. Padmanabhan Committee 38 has suggested CAMELS rating system for the Indian banks and CACS (Capital Adequacy, Assets Quality, Compliance and Systems) rating system for foreign banks in India.

9.15 CONCLUSION

The fast changes and new challenges will change the face of 21st century banking. When a customer reaches the premises of the bank, a 'bionic' (a word used in science fiction to describe that parts of the body are operated electronically) banker will welcome him. It may sound to be an exaggeration today but it indicates the vast transformation in the banking sector due to application of computer and information technology, which is in store for the future.

Banking made a modest start with simple intermediation techniques of pooling resources from the surplus sectors and allocating it to the deficit sectors. While undertaking the task of lending, banks preferred working capital finance and other non-bank financial intermediaries assumed the task of granting term loans to the deficit sectors for equipment and machinery etc. But this compartmentalization became dysfunctional and the stage of universal banking started setting in, having its first leg in the United States of America. It became prevalent in India too and banks started short term finance progressing gradually to medium term and long term loans. But progress knows no bounds. Banks started exploring non-fund based off-balance sheet items and bank guarantees and letter of credit became popular very soon. It suited both the banks and the customers as movement of funds was not involved unless there was a default. Project finance and infrastructure financing are emerging areas of financing. In fact, State Bank Of India has started three Strategic Business Units one each for Leasing, Project Finance and Corporate Accounts.

Technology and innovations have always spearheaded the path of progress. But computers with information technology are bringing great transformation in banking today. The monotony of repetitive work done by staff has been taken over by the computers releasing enough time for customer service, marketing of services, product development and innovations. The product / service delivery system is also changing fast. From the stage of 'actual banking' where branch serves as a delivery platform of

SOURCES:

38. Working Group on the System of Onsite Supervision over Banks, 1995, Chaired by S. Padmanabhan, RBI

services, banks are heading towards 'virtual banking' where a customer will be in a position to avail some of the services rendered by the bank, from the confines of home by networking of computers. In India, this blueprint of future may take some time but customers will be facilitated to a great extent by computerisation of the branches e.g. electronic funds transfer will mitigate the problems of inordinate delay and Automated Teller Machines will free the customers from the binding of operations of account in the working hours. It will be '24 hours 365 days banking.'

The financial assets were initially classified into primary and secondary securities depending on whether these were issued directly by the ultimate investors to the ultimate savers or through a financial intermediary. But banks have now a number of financial assets, which are a new breed altogether. Factoring, venture capital, forfaiting, financial futures, options, derivatives and other activities are adding to the long list of financial assets generated by banks.

Competition is another factor which has generated fast changes and innovations in products alongwith their faster delivery. The present banking sector scenario is customer dominated due to competition and their own agility and calculative behaviour. Costing and pricing have assumed greater importance to maintain the competitive edge and at the same time ensuring that the business does not become a losing proposition. The various techniques like product differentiation, calculating price sensitivity, working out utility of a product to a customer and value addition are being adopted to get a price edge. Banks may eventually devise a system of floating interest rate (both for deposits and advances) depending upon total value of the business offered by a customer. Banks would also like to enter into strategic alliances to maintain a competitive edge over other financial institutions.

Greater specialisation by banks in different niches of the market such as wholesale market comprising of corporate sector, retail market comprising of consumers and household sector and specific sectors like agriculture, export, small scale industries will rule the future. Banks may even go for super specialisation and may consider opening product-specific branches like ' Software Branch ' at Hyderabad, ' Diamond Branch ' at Bombay etc. This approach will enable them to handle high risk and technical proposals with the super specialities developed by them.

No doubt, directed credit has relevance in India and it will continue but there will be a strong shift towards the commercial considerations and viability of the projects will be the watchword. Decision taking tiers will be delayered to give faster service.

Unnecessary processes, which neither create value not assist in value creation for the customer will be weeded out and the concept of KAIZEN and Business Process Re-Engineering will have greater relevance to make the systems operating in banks more customer-friendly.

Banks will have two options either to specialise in a few selected areas as some banks in USA are doing or function like a ' Financial Supermarket ' having a bundle of services for the customers. There are genuine reasons to believe that supermarket concept will flourish in India. The reason is that the large network of branches, which the banks have opened in the wake of nationalisation can not be otherwise

utilised. The path of diversification leads to greater assurance for growth and profitability. Americans have a different system of 'unit banking' in contrast with the Indian 'branch banking' profile of banks.

Human resources with their skills, specialities, and innovative approach will be playing a greater role despite the increasing role of computerisation. Even foreign countries, which are pioneers in mechanisation, admit that in a service industry like banking, human factor is very important. The concepts of 'relationship banking' and 'service-profit chain' are based on the concept of inter-personal relations, where human factor plays the key role. The conviction is so strong that the concept of 'human capital' has been coined. Human capital refers to 'high level manpower' and 'human capital formation' is the process of acquiring and increasing the number of persons, who have the skills, education and experience, which are critical for the institution. Training has become a corporate strategy to assist in the development of individuals so as to develop competence in them to share greater responsibilities.

With all the above developments risk factor has multiplied. But there is no shying away from the risk element. Various types of risks like credit risk, liquidity risk, interest rate risk and foreign exchange risk have to identified. An index of risk has to be prepared so as to measure the risk. Finally risks have to be effectively managed. A system of risk forecasting may be devised. Industry-wise credit exposure limits may also be considered. They have also to guard against ' adverse selection of borrowers.' Various techniques of hedging the risks are prevalent and latest is the concept of derivatives. Asset-Liability Management is another technique based on the concept of total balance sheet management. Some other prevenitve and protective measures have also been adopted. The preventive regulation is Capital Adequacy Ratio (CAR) as laid down by the Bank Of International Settlements (BIS) The protective mechanism includes Deposit Insurance Scheme, where interest of depositors upto specified limits are protected. Such a scheme is compulsory even in advanced countries like United States Of America, France and Japan. This is also in vogue in India. Banks have also devised their own system of audit and inspection so as to ensure compliance of various instructions and regulations and ensuring no loss of funds or fraudulent practices to safeguard their own interest and also of their customers.

The progress and future prospects of all the three selected banks i.e. State Bank Of India, Bank Of India and Oriental Bank Of Commerce have been discussed in terms of the SWOT analysis, in-depth, in the previous chapters. They are among the progressive banks with grip over the present and vision for the future. The prospects of the future banking, discussed above, apply to the aforesaid banks, in particular, but are relevant for other banks as well but will depend upon their capacity to face the challenges and exploit opportunities. All these banks have stood the test of time and have a bright future ahead assissted by the promotional and regulatory framework provided by the Reserve Bank Of India. The RBI has earned applause by proper sequencing of reforms and insulating the Indian economy and the banking sector to successfully face various challenges and march into the next century with confidence. To the above success and future aspirations must be added the dynamic role that vast, trained and committed manpower of these banks have played and will continue to play in future.

CHAPTER 10

GROWTH AND PROFITABILITY OF SELECTED PUBLIC SECTOR COMMERCIAL BANKS IN INDIA SINCE 1991

SUMMARY AND CONCLUSIONS

The crucial role of banks, diversification of their functions and their close linkage with economic development have attracted attention of economists, bankers and policy makers. Banking sector has undergone rapid transition in India and world over during 20th century. In India, development of the banking sector can be divided into the following four phases:

(i) Foundation Phase : (From 1951 i.e. commencement of economic planning upto June 1969 i.e. pre-nationalisation phase)
(ii) Expansion Phase : (From July 1969 to 1984 i.e. post-nationalisation expansionary phase)
(iii) Consolidation and Diversification Phase (From 1985 to 1990 i.e. pre-reforms phase)
(iv) Liberalisation and Reforms Phase (From 1991 and onwards)

Nationalisation of 14 scheduled commercial banks in India on July 14, 1969 and 6 scheduled commercial banks on April 15, 1980 was a turning point in the history of banking in India. True to the expectations, commercial banks, in general, and public sector banks, in particular, made rapid strides in geographical coverage, mobilisation of deposits, deployment of credit and priority sector lendings. Number of commercial bank branches significantly increased from 8,262 in June 1969 to 63,513 in March 1997 and percentage of rural branches to total branches increased from 22.2% to 51.9% during the aforesaid period. Consequently, density of branches increased and population served per branch decreased from 64,000 in June 1969 to 15,000 in March 1997. Total deposits of scheduled commercial banks phenomenally increased from Rs. 4,079 crore in December 1969 to Rs. 5,05,599 crore in March 1997. Bank deposits as percentage of GDP (at current prices) increased from 13.7% in June 1969 to 43.2% in June 1996. Gross bank credit also substantially increased from Rs. 3,599 crore in June 1969 to Rs. 2,49,408 crore in March 1997. Another significant development was direction of much larger credit to hithertofore neglected priority sectors of the economy comprising of agriculture, small scale industries, small business finance and other weaker sections of the society from Rs. 441 crore by public sector banks in June 1969 (14.6% of bank credit) to Rs. 79,131 crore in March 1997 (41.7% of total bank credit).

While the above developments signalled welcome growth of banking sector in India, economic viability of banks took a downturn. The net profit of scheduled commercial banks was 0.12% in 1970s, 0.11% in 1980s, and a negative of (-) 0.07% in early 1990s. There was pre-emption of resources of banks in the form of high Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR). The quality

of loans portfolio of banks had deteriorated; adversely affecting cycling of funds and generation of income resulting in a decline of their profitability. The erosion of profitability affected their competitive strength. The capital base i.e. the ratio of paid-up capital and reserves to deposits of public sector banks at slightly over 2.85% in 1990-91 was much lower by international standards. Government, therefore, decided to bring about reforms in the financial sector. Banking sector reforms initiated in 1991 have focused the emphasis on the viability and operational efficiency of banks in India. The face of Indian banking is fast changing in the context of banking sector reforms, competition, globalisation and application of computers and information technology.

It is in the above background that an effort has been made by us to explore the role and nature of commercial banks in the post-reforms phase and to strike a balance between their social obligations and efficiency parameters. Growth without attention on viability of banks in the pre-reforms phase had resulted in non-viable operations of banks and it is a sign of sickness. On the other hand, profitability also requires the element of growth so that market share of the organisation is not only retained but also grows. A balanced approach towards profit and growth is, therefore, required.

We have, in our humble way, analysed the above burning issues of growth and profitability of the public sector banks in India. The three banks selected for deeper study are (a) State Bank Of India, a large sized bank, (b) Bank Of India, a medium sized bank and (c) Oriental Bank Of Commerce, a small sized bank. The key parameters of performance like interest expended, interest earned, net interest income intermediation cost, gross profit and net profit, when divided by total assets make the data comparable. Other ratios like Business Per employee, Profit Per employee, Capital Adequacy Ratio (CAR) and Ratio of Net Non-Performing Assets (NPAs) to net credit also provide a comparable base. As regards homogeneity in these three banks, all the three are public sector banks and they have accessed the capital market after initiation of the financial sector reforms in 1991.

Summary and Conclusions

The present thesis has been planned in nine chapters and the findings are summarised below:

First Chapter has been devoted to the **Role of Financial Sector in Economic Development.** Role of banks has to be examined in the larger context of the financial sector and its contribution to economic development. While the Classical economists, consisting of Adam Smith and Neo-Classical economists, consisting of Alfred Marshall found a close correlation between capital accumulation and economic development, they paid little attention to the transfer mechanism of savings into investment process, which involves a financial route. It was left to Keynes to emphasise the discontinuity and deny the automaticity of conversion of savings into investment.

In recent times, starting with the work of Gurley and Shaw in 1960, unitary theories of 'Supply Leading Phenomenon' (H.T. Patrcik 1966), 'Demand Following Phenomenon' (Arthur Lewis 1970) leading to its inter-active postulate have proved that financial sector and real sector are intertwined and

symbiotic. Goldsmithian 'Financial Superstructure' (1969) gave it a new recognition. 'Repressed Economies' caused by excessive interventionism lead to spearheading of 'Liberalist School' of thought by McKinnon and Shaw (1973). Liberalist pleading for market mechanism was based on the premise that financial sector and banks have attained required maturity. In addition to the above theoretical background, the Empirical Studies (Gurley Mid 1960s, Wallich 1969, Goldsmith 1966 and 1969 and Fry 1988) and Causality Studies (Jung 1986) are ample proof of the close link between growth of financial sector and economic development.

The recognition of the importance of broader measure of money other than M1 in understanding the effect of money and financial instruments in economy is a proof of the importance that financial sector has been assigned in recent times (Dr. P.N. Mehrotra 1979).

In order to facilitate financialisation, growing number of financial institutions intermediate through customer-friendly products. Development of financial markets is another facilitating factor both to deficit and surplus units. Integration of money market, capital market and credit market promote economic development. Money market offers liquidity to banks, when there is mismatch in their assets and liabilities. Although capital market offers competition to banks in their deposit mobilisation drive, yet it provides a support role too. Initial equity mobilised by corporates from capital market helps them in going to the credit market. of the financial sector specially the banking sector by offering required debt equity ratio. Banks also handle business of new issues etc. in the capital market as merchant bankers and strengthen their non-interest income base. Specialised Development Financial Institutions are also members of the same family and they are getting closer to banks with the emerging concept of 'Universal Banking'. This concept, which has arrived in India from USA, signifies that banks are undertaking term lendings for longer period and for larger amount including infrastructural financing in addition to their stronghold of working capital finance.

The recent experience of Currency Crisis in Asian countries like Thailand, Malaysia, South Korea and Philippines highlights the need of proper macro-economic setting alongwith proper regulations on international financial operations of the financial institutions, specially the banks so as to maintain proper correlation between the development of financial sector and real sector.

Indian experience of economic development in the context of financial sector development was studied by P. Ray and D. Bose (1997) covering the period 1950-51 to 1995-96 and they have concluded that there is a reasonably close correspondence between the growth experience of the economy, on one hand and savings and capital formation, on the other hand. Thus financial sector plays an important role in economic development.

In Chapter II, we have analysed profile of **Growth of Commercial Banks in India.** Banks are a member of the family of financial institutions. Although banks are one among many of their kind in the family of financial institutions and not a class among themselves (Gurley and Shaw 1961), yet they play a dominant role (Cargill 1986). The distinguishing features of banks are (a) they are largest

financial intermediaries as a group, (b) they are most diversified among the financial institutions as they deal with broadest spectrum of surplus and deficit units, (c) they dominate issuance of demand deposits, (d) they process clearing of negotiable instruments as per the mechanism established by the central bank of the country, (e) they play a catalytic role in creation of credit and (f) maximise allocative efficiency of capital by providing credit to most productive sectors of the economy.

Reserve Bank Of India has also played a crucial role in the development of banking sector in India. It has taken all round initiatives like introduction of Lead Bank Scheme, creation of Deposit Insurance and Credit Guarantee Corporation of India (DICGC) and National Bank for Agriculture and Rural Development (NABARD) and Unit Trust Of India (UTI). In addition to the promotional role, it has also strengthened the banking sector by its regulatory role. RBI has also made a commendable contribution by proper sequencing of banking sector reforms in India, which is a unique combination of liberalisation and prudential norms.

The phenomenal growth of commercial banks in India - both geographical and functional - has already been analysed above alongwith the negative features of declining profitability in the pre-reforms period i.e. before 1991. While some economists have described it as 'new inescapable development responsibilities (Kulkarni 1969), others felt that such activities were essential in view of shrinking business opportunities in the traditional fields (Chawla, Kilam and Mehta), yet the fact remains that declining profitability required immediate diagnostic and remedial measures. Hence need was felt for banking sector reforms.

In Chapter III, we have made in-depth study of **Banking Sector Reforms in India.** Banking industry is a multi-product service industry and the issues like banking sector liberalisation and reforms including prudential regulations and de-regulation of interest rates have engaged worldwide attention. A high power committee was set up in India in August 1991 to submit comprehensive recommendations on the structure, organisational systems and procedures known as 'Narasimham Committee on Financial Sector Reforms.' The main recommendations in the Report of the Committee, which was submitted in November 1991 included (a)reduction in Statutory Liquidity Ratio in phases to 25%, (b) operation of Cash Reserve Ratio in terms of monetary policy goals, (c) redefining the priority sector and reducing the target to 10% instead of the present 40%, (d) phased de-regulation of interest rate but with adequate caution, (e) Capital Adequacy Ratio of 8% to risk-weighted assets, (f) bifurcation of investment portfolios of banks into 'current' and 'permanent', (f) classification of loan assets into standard, sub-standard, doubtful and loss assets, (g) establishing Special Recovery Tribunals, (h) setting up of Assets Reconstruction Fund, (i) entry of private and foreign banks, (j) abolition of Branch Licensing Policy and (k) computerisation of branches to improve customer service and efficiency of banks. All the above recommendations of the Committee have been accepted and implemented except (a) reduction in priority sector lendings target to 10% due to imperfections in the credit market and importance of those sectors in the economy and (b) establishment of Assets Reconstruction Fund (ARF) as it was felt that the concerned banks can better follow up their bad debts. The recommendation regarding

reorganisational pattern of banks, has been partially accepted and approval has been accorded for setting up of Local Area Banks.

As banks have acquired greater strength and with the changing scenario, need was felt for second generation of reforms in the banks. Hence Second Narasimham Committee on Banking Sector Reforms has submitted its Report in April 1998 with a view to further strengthening the foundation of the banking system streamlining the procedures and structural changes in the system. The important recommendations are (a) 5% risk-weight to Government and other approved securities, (b) raising of the minimum Capital Adequacy Ratio from the present 8% to 9% in the year 2000 and 10% by 2002, (c) average level of net NPAs to be brought down below 5% by the year 2000 and to 3% by the year 2002, (d) a general provision of 1% on standard assets in a phased manner and (e) review of the start-up capital requirement of Rs.100 crore for new private banks.

Chapter IV has been devoted to the most crucial issue of **Profitability and Efficiency of Commercial Banks in India.** Profit is a reward for (a) 'uncertainty bearing'(Prof. Knight 1921), (b) 'risk bearing' (Hawley 1907), (c) 'innovations' (Joseph Schumpeter 1934), (d) 'cause and effect of economic dynamics' (J.B. Clark), (e) and a useful tool of analysis for examining economic viability of the organisation by financial experts, lenders and investors. Unlike reward for other factors of production, it may turn negative, if not properly planned. The terms 'profit', 'profitability' and 'productivity' are inter-related but connote different aspects. Profit implies absolute value. Profitability is a ratio analysis, which inter-relates variable of profit with another variable. Productivity ratio is linked with input-output relationship e.g. 'Business Per Employee' and 'Profit Per Employee.'

'Backward Linkages Technique' (Varsha Varde and S.P. Singh) has been used as a technique to identify net profit of banks by identifying (a) 'Primary Factors' i.e. 'Interest Spread' and 'Burden' (b) 'Secondary Factors'[(Interest Spread = interest earned-interest expended) and (Burden = Non-Interest Income-Non-Interest Expenses)], (c)'Tertiary Factors' i.e. composition and yield of various factors and (d) 'Fourth Associate Factors' i.e. Government policies, bank policies and wage agreements etc. We have added 'Supplementary Factors', which comprise of global factors, computerisation and competition from other financial markets and other financial institutions.

The following important ratios have been used by us for examining the profitability, efficiency and productivity of banks:

(1) Interest Spread Ratio (ISR) $= \dfrac{\text{Interest Spread} \times 100}{\text{Total Assets}}$

(2) Gross Profit Ratio (GPR) $= \dfrac{\text{Gross Profit} \times 100}{\text{Total Assets}}$

(3) Net Profit Ratio (NPR) $= \dfrac{\text{Net Profit} \times 100}{\text{Total Assets}}$

(4) Return on Equity (ROE) = $\frac{\text{Net Profit}}{\text{Equity}} \times 100$

(5) Intermediation Cost Ratio (ICR) = $\frac{\text{Intermediation Cost}}{\text{Total Assets}} \times 100$

(6) Asset Utilisation Factor (AUF) = $\frac{\text{Total income}}{\text{Total Assets}} \times 100$

(7) Non-Performing Assets to Net Advances = $\frac{\text{Net Non-Performing Assets}}{\text{Net Advances}} \times 100$

(8) Average Business Per Employee = $\frac{\text{Average Deposits + Average Advances}}{\text{Total Number of employees}}$

(9) Net Profit per employee = $\frac{\text{Net Profit}}{\text{Total Number of employees}}$

(10) Capital Adequacy Ratio = $\frac{\text{Tier I + Tier II Capital}}{\text{Risk Weighted Funded or Non-Funded Assets}} \times 100$

The above ratios are conventional ones but keeping in view the latest changes in the banking sector scenario, we have developed a few more ratios while developing an augmented model in Chapter VIII. An analysis of income and expenditure of all scheduled commercial banks during post-reforms phase reveals the following features:

(i) Interest income as percentage of total assets for all scheduled commercial banks (ASCB) declined from 10.27% in 1991-92 to 8.63% in 1994-95 but improved to 9.88% in 1996-97 Income Recognition and Assets Classification (IRAC) norms lead to initial decline of interest income. Decline in rate of interest on advances and growth of priority sector lendings attracting lower rate of interest are other contributory factors. Subsequent improvement is due to the stabilising position of the banks after reforms measures.

(ii) Interest expenses as percentage to total assets (ASCB) initially decreased from 7.20% in 1992-93 to 5.63% in 1993-94 but thereafter increased and was 6.67% in 1996-97. The reason is increasing preference for time deposits as savings medium involving higher cost of deposits for banks.

(iii) Intermediation cost, also defined as other operating expenses, has increased due to high wage bill in case of public sector banks and high cost of computerisation for foreign banks. Intermediation Ratio, after initially increasing from 2.60% (ASCB) in 1991-92 to 2.94% in 1995-96, has declined to 2.85% in 1996-97.

(iv) Net profit as percentage to total assets after turning negative i.e. -1.08% and -.85% in 1992-93 and 1993-94 respectively improved to 0.68% in 1996-97 (ASCB) due to a general reduction in NPAs and provisions for bad and doubtful debts, more profitable utilisation of funds released due to reduction in CRR and near- market-related interest on Government securities.

(v) Net Non-Performing Assets as percentage to net credit has increased for some of the banks in 1996-97 and was highest at 10.07% for the nationalised banks (though lesser than last year).

(vi) All public sector banks, except 2, achieved the target of 8% in respect of Capital Adequacy Ratio in March 1997.

Chapter V is devoted to the study of **State Bank Of India and its profile**. The domestic branches of State Bank Of India represent 17.9% of total ASCB branches in India. Out of 8,836 branches in India in March 1997, 49.7% branches were in rural areas. SBI deposits at Rs. 1,03,767 crore in March 1997 accounted for approximately 20% of ASCB deposits and about 73% deposit were from retail customers providing a large customer base. SBI advances in India at Rs. 55,023 crore in March 1997 represented 22.1% of ASCB advances. Priority sector lendings of SBI increased from Rs. 11,646 crore in March 1992 to Rs. 19,337 crore in March 1997. Interest spread as percentage of total assets, after initially declining from 3.63% in 1991-92 to 2.61% in 1993-94 improved to 3.43% in 1996-97 due to the reasons stated in items (i) and (ii) above. SBI maintained growth of its net profits consistently in post-reforms period, whereas several banks had gone in red. SBI net profit increased from Rs. 175.05 crore in March 1992 to Rs. 1,329.30 crore in March 1997 representing average annual growth of 132%, which is highest among all category of banks. The reasons stated in Chapter IV above are applicable to SBI as well. Its Return on Assets, Return on Equity, Business Per Employee and Profit Per Employee have considerably improved during post-reforms period but on inter se comparison, these ratios are highest for OBC. SBI has introduced credit risk management system and well diversified advances portfolio cutting across various industries with exposures under each category restricted to reasonable levels.

SBI has diversified its activities and is one of the nominated agencies for import of gold / silver under the Gold Silver Jewellery Export Promotion and Replenishment Scheme. Leasing Strategic Business Unit (SBU) of the Bank provides lease finance. Bank's Project Finance SBU provides funds to high value projects in infrastructure and core sector industries and the Bank has made significant progress in the field of international consultancy. In addition to these factors, other strengths of SBI are its large market share, higher proportion of low cost deposits, large base of customers and large network of branches. Its weak point is increase in its NPAs from 6.61% in March 1996 to 7.30% in March 1997. But with various preventive and curative measures, these have come down to 6.07% in March 1998.

We have prepared a **Profile of Bank Of India** in Chapter VI. The number of branches of Bank Of India increased from 2,323 in March 1992 to 2,456 in March 1997 registering an increase of 5.7% over a period of 5 years as the Bank has been concentrating on consolidation rather than expansion. Domestic deposits of Bank Of India increased from Rs. 13,074 crore in March 1992 to Rs. 26,240 crore in March 1997; representing an average annual increase of 20.1% by launching new generic schemes, marketing drive and rural publicity campaign. Its market share in domestic deposits, however, declined from 5.5% in March 1992 to 4.9% in March 1997. Total advances of BOI increased from Rs. 6,767 crore in March 1992 to Rs. 14,363 crore in March 1997; thereby registering an average annual growth of 21%.

Its priority sector lendings increased from Rs. 2,545 crore to Rs. 5,044 crore during the aforesaid period ; enlarging its share in total bank credit from 40% to 44%.

The interest spread of BOI after declining from 2.25% of total assets in 1991-92 to 1.82% in 1992-93, improved to 3.21% in 1996-97. Its non-interest income as percentage of total assets increased from 11.1% in 1991-92 to 12.2% in 1996-97. The Bank suffered net loss of Rs. 331.12 crore and Rs. 1,089.15 crore in 1992-93 and 1993-94 respectively. But it made a turnaround and its net profit amounted to Rs. 360.02 crore in 1996-97. Its Net NPAs of 7% in March 1996 decreased to 6.5% of net credit in March 1997. This area has to be specially guarded as the Bank has suffered losses in the past. Other ratios like Return on Assets, Return on Equity, Deposits and Advances Per Employee, Net Profit Per Employee improved during the year 1996-97 and a comparative position of the selected 3 banks is given in the table in Chapter VIII.

The bank has endeavoured to maximise productivity of staff by suitable training, fast track promotions and introduction of Reward and Recognition Scheme. As a measure of customer service, the Bank has organised Customer Rights Awareness Programmes at very large branches and has also introduced the system of customer audit. The Bank has completed nearly a decade of credit card business and has also entered the segment of term finance / project finance.

We have examined the performance of **Oriental Bank Of Commerce** VIII Chapter. OBC is smallest as compared to the aforesaid two banks but its small size (755 branches in March 1997) is its advantage. On one hand, it can exercise better control over branches and on the other hand, it still has the potential for growth and for this reason, its growth of branches at 41.6% during 1992-97 was highest as compared to State Bank Of India, Bank Of India and All Scheduled Commercial Banks. Its domestic deposits at Rs. 10,054 crore recorded average annual growth of 35.9% during 1992-97 due to introduction of new schemes and effective marketing techniques. It is no doubt true that term deposits involve higher cost but for OBC, such deposits have an advantage too by providing stable deposit and diversified deposit base from household sector. Its market share in domestic deposits has increased from 1.5% in March 1992 to 2% in March 1997.

As regards advances in India by OBC, it crossed Rs. 4,000 crore mark (Rs. 4,886 crore) in March 1997 as compared to 1,763 crore in March 1992 registering an average annual growth rate of 35.4% during 1992-97. Its market share in advances increased from 1.3% in March 1992 to 2% in March 1997 by achieving growth in advances to trade, industries, agriculture, small scale industries, retail trade, small business finance, professionals and housing loans.

The ratio of interest spread of OBC to total assets has increased from 2.83% in March 93 to 3.89% in March 1997 due to lower NPAs, lesser provisions and contingencies and efficient assets liabilities management. Its Intermediation Cost Ratio decreased from 2.53% to 2.19% during the aforesaid period by exercising control over operating expenses. Consequently, its net profit ratio to total assets has improved from 0.43% to 1.56% during the above mentioned period.

The weak point of OBC is its higher proportion of time deposits to total deposits, which has increased from 63% in 1991-92 to 68% in 1996-97 and is highest as compared to SBI (58%) and Bank Of India (64%) and All Scheduled Commercial Banks (66%). Net NPAs to net credit of OBC have sharply risen from 3.66% in March 1996 to 5.84% in March 1997. It is lower than SBI, BOI and Public Sector Banks as a group but that is not a major consideration and OBC has to initiate suitable measures - both preventive and curative - to contain NPAs. Capital Adequacy Ratio (CAR) of OBC has improved from 16.9% in March 1996 to 17.53% in March 1997.

OBC has laid down thrust on customer service and taken initiatives like Citizens Charter to make customers aware of the Bank's schemes, services and facilities and obligations of the Bank to its customers. Human resources, being valuable resources, have received due attention by the Bank for development of the required skills and positive attitude towards work and customers.

We have also made an attempt to develop an **augmented Bank Efficiency Model '(BANKEM)'** in Chapter VIII in order to comprehensively evaluate and compare the performance of the commercial banks. We have applied the Model for Comparative assessment of the Position of the three selected public sector banks. The factors like (i) Branch Network (domestic as well as foreign), (ii) Market Share (domestic deposits and advances), (iii) Income Ratios (Interest Spread Ratio and Non-Interest Income as percentage to total assets), (iv) Expenses Ratio (Intermediation Cost Ratio), (v) Profitability Ratio (Gross Profit Ratio and Net Profit Ratio), (vi) Productivity Ratios (Business Per Employee), (vii) Technology Ratio (Ratio of totally computerised branches to total no. of branches), (viii) Efficiency Ratios (Return On Equity and Assets Utilisation Factor), (ix) Diversification base (No. of subsidiaries and affiliated in India and abroad) and Prudential Norms Ratio (Net NPA Ratio to Net Credit and Capital Adequacy Ratio) have been taken into account.

The equation alongwith brief description of variables is given below:

SIMPLE EQUATION

$$GS = \sum_{i=1}^{n}[G(i)*P(i)] \div \sum_{i=1}^{n} P(i)$$

where, P (i) = Weightage of the ' i ' th Parameter (depending on the relative importance of the parameter)

G (i) = Grade for the ' i ' th Parameter (based on performance & rank depending thereon)

GS stands for Grade Score and is equal to the sum total of the grades or numerical values assigned to the grades.

The above equation signifies flat data for one year .

EQUATION FOR TIME SERIES DATA

When Time Series Data has to be presented, the above equation will have further dimensions and it can be presented in the following manner :

$$\sum_{t=1}^{m}\left[\left\{\sum_{i=1}^{n}\{G(i)*P(i)\}\right\} \div \sum_{i=1}^{n}P(i)\right] /m$$

This equation analyses performance over a period of 'm' years. As after introduction of the banking sector reforms in India, the position of banks has stabilised from 1996-97, we have taken single year data i.e. for the year 1996-97. After working out the actual performance of banks, we have applied grades (with weightages depending upon their importance) to the concerned banks in the following table:

Grading on the basis of relative performance (rank) of selected banks In March 1997

Ratios / Valuation Standards	Parameter Weightage P(i)	State Bank Of India Performance		Bank Of India Performance		Oriental Bank Of Commerce Performance	
		G(i)	G(i)*P(i)	G(i)	G(i)*P(i)	G(i)	G(i)*P(i)
1.Network of Br. in India	10	A	100	B	80	C	60
2. Network of Foreign Br.	10	A	100	B	80	C	60
3. Market Share of Domestic Deposits	10	A	100	B	80	C	60
4. Market share of Advances in India	10	A	100	B	80	C	60
5. Interest Spread Ratio	11	B	88	C	66	A	110
6. Non-Interest Income Ratio	11	A	110	B	88	C	66
7.Intermediation Cost Ratio	11	C	66	B	88	A	110
8. Gross Profit Ratio	10	B	80	C	60	A	100
9. Net Profit Ratio	14	C	84	B	112	A	140
10.Business Per Employee (Rs. in lac)	10	C	60	B	80	A	100
11.Technology Ratio	13	B	104	A	130	C	78
12. Assets Utilisation Factor	10	B	80	C	60	A	100
13. Return On Equity	10	C	60	A	100	B	80
14. Diversification Base	13	A	130	B	104	C	78
15. Net NPAs Ratio	12	C	72	B	96	A	120
16. Capital Adequacy Ratio	11	B	88	C	66	A	110
Total	176		1422		1370		1432

On the basis of the above equation, the Net Score of the Banks out of a total of 10 stands out to be

S.B.I. = 1422 / 176 = 8.08

B.O.I.= 1370 / 176 = 7.78

O.B.C.= 1432 / 176= 8.14

On the basis of the maximum score achieved by Oriental Bank Of Commerce i.e 8.14, it can be deemed to be the best performer followed by State Bank Of India 8.08 score. A large base of total assets has neutralised the high absolute values of different parameters for SBI but high value of assets holds the key for future. Bank Of India is not far behind and has a score of 7.78 and possesses the potential of being forerunner in the near future. We have also conducted the following SWOT analysis. As it is more an introspective exercise, the banks have themselves to identify their weak and strong points from the following parameters and take such action as is considered necessary by them.

SWOT Analysis of Oriental Bank Of Commerce, Bank Of India & State Bank Of India

Particulars	Oriental Bank Of Commerce	Bank Of India	State Bank Of India	Our suggestions
@ % Growth in deposits	35.9	18.1	18.7	Greater application of computers, excellence in customer service, marketing of the services, product innovation and meeting the competitive edge will be useful exercise.
@Market share in deposits	2.0	4.9	20.5	Special emphasis be laid on increasing market share of deposits because it is the test of meeting the competitive edge and growth.
% of demand deposits	32	36	42	OBC has to make special efforts for raising demand deposits, which are low cost deposits.
@ % increase in advances	35.4	22.4	16.9	Diversification of lending depending upon the expertise and area of consumer finance may be explored.
Market share in advances	22.2	5.8	1.9	While doing the business budget exercise, market share analysis will be of great help so that it is enhanced over a period of time.
Net Interest Income (Interest Spread Ratio) to Total Assets	3.89	3.21	3.43	Containing NPAs, fixing profitable and competitive interest rates for increasing yield on advances, the strategies for increasing advances stated above, mobilising low cost deposits and efficient management of investment portfolios may be some strategies for enhancing net interest income.
Non-Interest Income Ratio to Working Funds *	0.90	1.29	1.69	Non-Fund based business like bank guarantees & letter of credit, leasing and enhancing remittance business can help enhancing non-interest income. OBC will have to make special efforts.

Particulars	Oriental Bank Of Commerce	Bank Of India	State Bank Of India	Our suggestions
Intermediation Cost Ratio to Total Assets *	2.19	2.77	2.94	Wages and staff strength are most important factors in intermediation cost and as such enhancing productivity is the desired approach for BOI and SBI.
Gross Profit Ratio to Total Assets *	2.60	1.53	2.17	The strategies stated above with special attention on reducing NPAs and booking profitable business will enhance GPR.
Net Profit Ratio to Total Assets *	1.56	0.95	0.85	As stated above
Net Profit Per Employee * (Rs. in lac)	1.33	0.68	0.56	For SBI, net profit per employee has improved to Rs. 0.77 lac in March 1998. While fixing budgetary targets, productivity goals be also assigned to branches.
Business Per Employee *	130	68	56	Banks will have to segregate high value accounts for providing specialised services.
Capital Adequacy Ratio *	17.5	10.26	12.17	Containing NPAs is crucial for maintaining a reasonably improving CAR. SBI CAR has improved to 14.58% in March 1998.
Net NPAs to Net Credit *	5.64	6.52	7.3	Effective credit management, NPA Reduction Budget, identifying, hedging and managing risks are essential to bring NPAs to a level below 5%. SBI has succeeded in reducing its NPA ratio to 6.07% in March 1998.
Priority Sector Lendings %	42	44	38	While achieving the target, the thrust should be on financing the viable proposals with post-sanction follow up to ensure proper end use of funds.
Credit-Deposit Ratio %	48.6	57.4	59.7	CD Ratio analysis is important to plan utilisation of resources for lending, which is a profitable function of banks. A balance between risk and yield has to be maintained.
Fully computerised branches %	3.4	8.4	7.6	Computerised branches are a great resource for customer service and business development. It requires cost-benefit exercise and planning.
No. of subsidiaries & Jt. Ventures	---	9	20	Need for subsidiaries is to be examined in the light of business potential and whether a separate establishment will be viable.

@ Average annual increase during March 1992-March 1997 * As in March 1997

It will be observed from the above that despite having smaller network of branches with no branch abroad, lesser market share, lesser number of computerised branches and no subsidiaries / joint ventures, Oriental Bank Of Commerce has strong points in the shape of profitability ratios, productivity ratios and prudential norms ratios. State Bank Of India possesses strong points in the shape of largest network of branches in India and abroad, largest number of subsidiaries and joint ventures, largest share of deposits with higher proportion of low cost deposits, largest share of advances and largest number of computerised branches. Bank Of India is also has its strong points in technology adoption and diversification.

In Chapter IX, we have ventured to take **Banking in the Next Millennium.** Banking sector has diversified and concept of 'universal banking' is gaining momentum. Banks are entering into new fields like long term lending, leasing , project financing, merchant banking, factoring, venture capital and are planning for travel related business. Even infrastructure financing, is now being taken up by State Bank Of India, which involves heavy amount and for long period. New financial assets like certificate of deposits, commercial paper, securitised debts, financial futures, options and derivatives and non-fund based instruments like letter of credit and bank guarantees will have a greater role to play. Banks will have to evolve suitable strategies for hedging bank risks like interest rate risk, credit risk, liquidity risk and foreign exchange rate risk, which are increasing manifold. With greater exposure of lending for long term and for larger amount, they are developing skills for assets liability management (ALM) so that they do not experience liquidity crisis and at the same time, their earnings are maximised.

Computerisation has revolutionised banking. Advanced Teller Machines (ATMs), electronic transfer of funds (EFTs), smart cards (also known as electronic purses), tele-banking and log-in facility by networking the computers of customers with bank computers for selected services will be the order of the day.

Globalisation of banking is providing access to low cost funds in international financial markets. It will increase further but it has to be handled with care so that Asian Currency Crisis, which engulfed several countries like Thailand, Philippines, Malaysia, South Korea and Indonesia does not recur and Indian banks remain protected against such shocks. EURO is going to be a significant development. and will be a convenient factor for the banks as banks will have to hedge against one currency instead of 15 currencies and cost of hedging will be minimised.

Banks will have to focus on tailor made schemes as per the needs of customers. Courteous behaviour to the customers, proper work culture, promptness of service and marketing approach will give competitive edge to banks and will attract greater business. Total Quality management (TQM), Quality Circles (QCs) Zero Defects, Relationship Banking and Japanese KAIZEN model (stressing ongoing improvement) are some of the latest techniques to maximise customer satisfaction. Financial services pricing and human resources will play a crucial role.

At the same time banks have to be conscious towards safety of public funds and audit mechanism - both off-site and on-site - will require gearing up especially in the field of application of computers because it involves additional risk factors.

While **concluding** , we may state that commercial banks in India have shown resilience and have emerged stronger in the post-reforms period. With identification of non-performing assets, their balance sheets have emerged cleaner and more transparent. Additional capital has been infused and some of the public sector banks have accessed the capital market. All except two PSBs have achieved CAR of 8% in March 1997. Banks have now greater freedom in opening the new branches, interest rates (both for deposits and advances) have been deregulated to a great extent, CRR stands reduced to 11% for profitable profitable deployment of funds and interest rate on Government securities are more or less market related.

But liberalisation poses additional challenges. Banks have to determine rate of interest themselves. Competition is severe due to arrival to new players specially the foreign banks and new public sector banks. Risk factors related to both fund based and non-fund based business have increased. With growth in their non-fund based business, 'contingent liabilities' are also mounting in respect of all the banks. Banks have to identify, measure and manage risks through suitable techniques like risk indexing and hedging and they have also to price the risks. With infrastructure financing on the cards, banks have to develop more skills for Asset-Liability Management. Banks will have two options either to specialise in a few selected areas as some banks in USA are doing or function like a ' Financial Supermarket ' having a bundle of services for the customers. There are genuine reasons to believe that supermarket concept will flourish in India due large network of branches.

The progress and future prospects of all the three selected banks i.e. State Bank Of India, Bank Of India and Oriental Bank Of Commerce, which have been discussed in terms of the SWOT analysis, in-depth, are among the progressive banks with grip over the present and vision for the future. All these banks have stood the test of time assisted by the promotional and regulatory framework provided by the Reserve Bank Of India. The RBI has earned applause by proper sequencing of the reforms and insulating the Indian economy and the banking sector to successfully face various challenges and march into the next century with confidence. The augmented **'Bank Efficiency Model BANKEM'** developed by us and grade scores of the banks worked out by us are only tools of analysis and the results do not cast any reflection on banks. Each bank possesses as much strength as any other bank and they do have a prosperous and bright future ahead as they have the strength to meet the future challenges arising out of competition, deregulation and globalisation. The prospects of the future banking, discussed above, apply to them as well but will depend upon their capacity to face the challenges and exploit the opportunities. To the above success and aspirations must be added the dynamic role that vast, trained and committed manpower of these banks have played and will continue to play in future.
